International Labour Conference
83rd Session 1996

Report V

Employment policies in a global context

International Labour Office Geneva

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Fifth item on the agenda

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CORRIGENDUM

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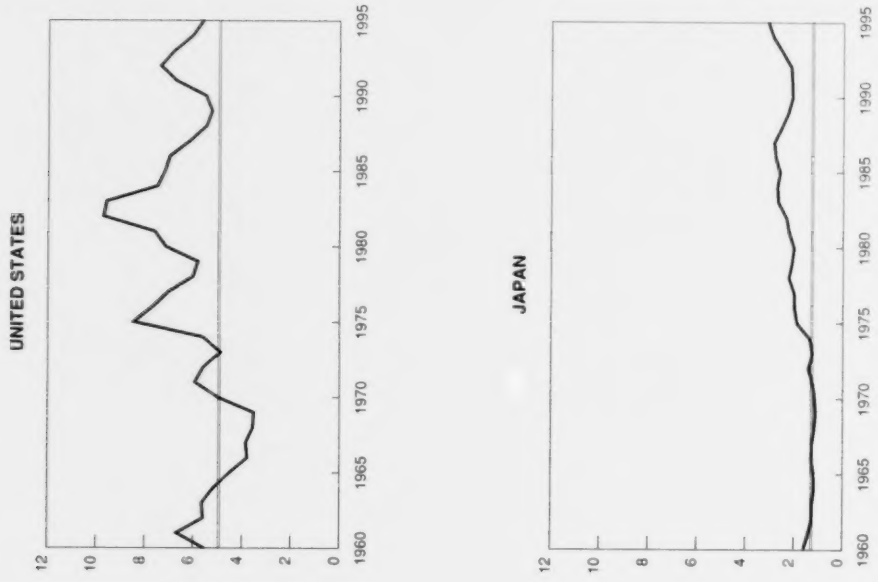

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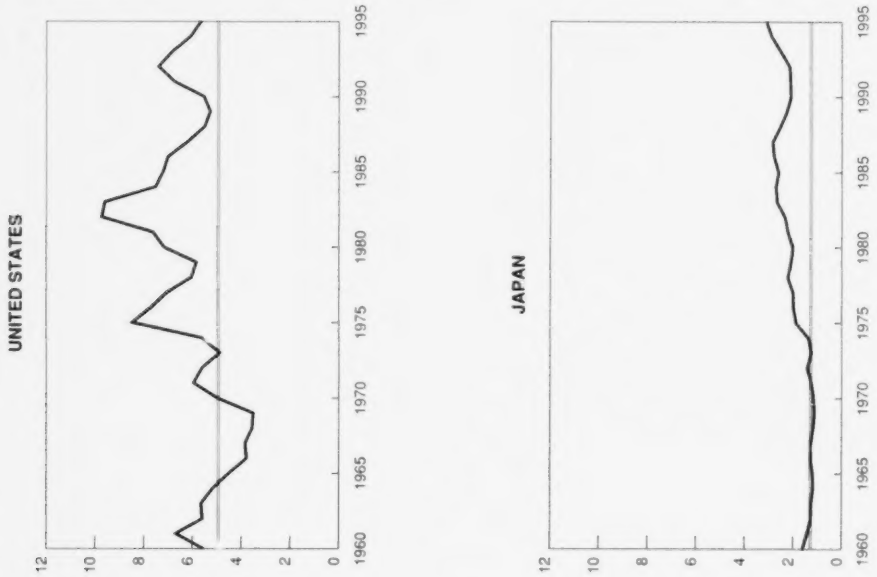


INTRODUCTION

The Governing Body of the International Labour Office decided at its 259th Session in March 1994 to put on the agenda of the 83rd Session of the International Labour Conference in 1996 an item for general discussion entitled "Employment policies in a global context". The choice of this topic was influenced by two important considerations. The first was the accumulating evidence of a worldwide deterioration in the employment situation over the past two decades, with persistently high unemployment in the industrialized countries, the emergence of mass unemployment in the transition economies since 1990, and increased unemployment and underemployment in many parts of the developing world. The second was the recognition that these employment problems had to be dealt with in the new context of a rapidly globalizing world economy characterized by the growing importance of international flows of trade and financial capital and a worldwide shift towards more open and market-oriented economic policies. In view of these developments it was considered timely for the Conference to discuss afresh issues of employment policy in a vastly changed and still changing global context.

Since the taking of this decision of the Governing Body there has been a major development which has a bearing on the forthcoming general discussion. This was the World Summit for Social Development which took place in Copenhagen in March 1995. The Declaration adopted by the Summit included the objective of full employment among its ten commitments, while the Programme of Action defined policies and actions for attaining that objective. The Summit also designated the ILO as the lead agency for the implementation of the employment component of the Programme of Action.

The ILO played a major role in the preparatory process of the Summit. It contributed a background paper on employment issues to each of the two Preparatory Committee meetings. The second of these papers, entitled "Towards full employment", drew on the outcome of an informal Tripartite Meeting at the Ministerial Level held on 10 June 1994. The ILO also launched a new series of reports on the world employment situation, the first of which — *World employment 1995* — was published a few weeks before the Summit. An abridged version of this, entitled *The promotion of employment*, was presented to the 1995 International Labour Conference as the Report of the Director-General and was the subject of discussion in plenary session. There is thus a body of recent ILO work which can be drawn upon for the forthcoming general discussion in addition to the present report.

Given the adoption of the objective of full employment by the Social Summit, the present report is organized around the theme of full employment. It examines whether the concept of full employment is still relevant and realistic as a policy objective in countries at different levels of development in the context of contemporary labour market conditions and a globalized world economy. It then discusses the policies required to achieve full employment in industrialized, transition and developing countries.

The structure of the report is as follows. It begins in Chapter I with a brief discussion of the changing global context for national employment policies, noting the main features of the globalization of the world economy and their implications for employment policy. Chapter II then confronts the main sources of scepticism over the continuing relevance of the concept of full employment and discusses how the concept should be updated. Chapter III documents the drift away from full employment in the industrialized countries in the past two decades — persistently high unemployment, rising wage inequality and the growth of "bad jobs" — and then discusses policies for reversing these trends. Chapter IV examines the rise in mass unemployment in the former centrally planned economies in the wake of their transition towards a market economy. It focuses on possible strategies for reducing unemployment in the face of the further economic restructuring that is necessary in these economies before they become fully-fledged market economies. Chapter V examines whether the objective of full employment is meaningful in developing countries, given that the characteristics of employment in these countries are vastly different from those in industrialized countries. It also reviews employment trends and then focuses on the central issue of how employment outcomes can be improved in the context of the ongoing economic reforms in many developing countries. Chapter VI concludes the report by summarizing the main policy issues.

It has not, of course, been possible to be exhaustive in a short report of this nature. The report has, of necessity, focused only on issues considered to be of strategic importance in current discussions on employment policy at both the international and the national level. This has meant that a number of other issues that are important in their own right, such as gender equality in the labour market, education and training policies, the role of active labour market policies, and the relationship between economic growth and the environment, have not been covered. This should not, however, preclude the raising of these and other issues in the Conference discussion.

CHAPTER I

THE GLOBAL CONTEXT

The world economy has undergone significant change in recent decades in terms of the structure of production and employment as well as in the scale and nature of economic relationships among nations. There has been a significant shift in the structure of production and employment from agriculture to industry in many developing countries, while in the industrialized countries there has been a continuing shift from industry to services. These changes have occurred in the context of the growing globalization of the world economy.

A key aspect of globalization has been the rapid growth in world trade (table 1.1). Since 1984 the volume of world trade has grown faster than world output (table 1.2). As a result export-to-GDP ratios have increased in a majority of OECD countries and in developing countries in Asia and Latin America. The growth of exports, especially of manufactured goods, from developing countries has been particularly rapid.[1] This trend has been fuelled by the wave of trade liberalization across the world and the development of regional trade liberalization arrangements. It is a trend that can be expected to continue with the recent completion of the Uruguay Round of GATT and the establishment of the World Trade Organization. The Uruguay Rounds, fully implemented, will ensure further multilateral tariff reductions as well as extend trade liberalization to trade in agricultural products and services.[2]

At the same time flows of foreign direct investment (FDI) have also increased sharply (table 1.3.), especially to developing countries. The average annual flows have increased more than threefold since the early 1980s for the world as a whole, while for developing countries it had increased fivefold by 1993. These increasing flows of direct investment have been accompanied by the growth of globally integrated production systems characterized by growing intra-firm trade in intermediate products and new forms of outsourcing of work across national frontiers.

Other financial flows have also increased with the globalization of financial markets. This has included massive increases in the volume of trading in foreign exchange and in new financial instruments such as derivatives. Cross-border trading in bond and equity markets has also increased rapidly. A striking new development has been the large flows of equity investment towards emerging markets.

These changes have occurred in the context of growth of world GDP which has been slower than in the period prior to 1973. Since 1981 world GDP has grown at an average rate of 3 per cent per annum, except during the recent recession in the industrialized countries (table 1.2). Since 1990 growth in the developing countries has been significantly faster than the world average, although it has varied considerably across different developing regions. Growth rates have been exceptionally high in Asia, while sub-Saharan Africa has on average been experiencing negative growth in per capita GDP (table 1.4).

Table 1.1. Growth of world trade (goods and services), 1984-1995

	Annual average		Estimate	Forecast
	1984-89	1990-93	1994	1995
World total				
Volume	6.4	4.6	8.7	7.9
Value ($)	3.0	1.2	2.1	8.0
Export volume				
Developed countries	5.9	4.2	8.1	6.9
Developing countries	7.3	7.6	11.3	11.0
Import volume				
Industrial countries	7.9	3.1	9.2	7.1
Developing countries	3.3	9.5	8.5	11.1

Source: IMF: *World Economic Outlook*, Oct. 1995.

Table 1.2. Growth of real GDP, 1966-94

	Annual average				Estimate
	1966-73	1974-80	1981-90	1991-93	1994
World total	5.1	3.4	3.2	1.2	2.8
Developed countries	4.8	3.0	3.2	1.3	3.0
OECD countries	4.8	2.9	3.1	1.2	2.9
Non-OECD countries	8.4	7.0	5.0	6.2	5.8
Eastern Europe and Central Asia	7.0	4.9	2.9	– 9.4	– 7.5
Developing countries	6.9	5.0	3.3	4.6	4.6
East Asia	7.9	6.8	7.6	8.7	9.3
China	8.5	6.3	9.9	12.3	11.7
South Asia	3.7	4.0	5.7	3.2	4.7
Sub-Saharan Africa	4.7	3.4	1.7	0.6	2.2
Latin America and the Caribbean	6.4	4.8	1.7	3.2	3.9
Middle East and North Africa	8.5	4.7	0.2	3.4	0.3

Source: World Bank: *Global economic prospects and the developing countries*, 1995.

Table 1.3. FDI inflows, 1981-93 (billions of dollars)

	Annual average				
	1981-85	1986-90	1991	1992	1993
All countries	50	155	157	155	173
Developed countries	36	129	117	104	103
Transition countries	0.02	0.1	3	5	6
Developing countries	14	26	40	51	70
Africa (%)	15.3	12.0	5.6	5.0	2.6
Asia (%)	46.2	36.0	52.4	57.3	64.1
Latin America (%)	38.5	52.0	31.2	26.6	23.0

Source: UNCTAD: *World Investment Report 1994*; IMF: *Balance of Payments Statistics Yearbook 1994*.

Table 1.4. Growth of real per capita GDP, 1981-95

	Annual average		Estimate	Forecast
	1981-90	1991-93	1994	1995-2004
World total	1.2	– 0.4	1.2	1.9
Developed countries	2.2	0.7	2.4	2.4
OECD countries	2.2	0.6	2.3	2.3
Non-OECD countries	2.2	4.7	4.4	4.5
Eastern Europe and Central Asia	1.6	– 9.8	– 7.9	2.9
Developing countries	1.2	2.6	2.7	3.5
East Asia	6.3	7.2	7.6	6.6
China	8.2	11.0	10.5	—
South Asia	3.1	1.1	2.7	3.6
Sub-Saharan Africa	– 0.9	– 2.3	– 0.7	0.9
Latin America and the Caribbean	– 0.5	1.3	2.0	1.9
Middle East and North Africa	– 3.0	0.7	– 2.2	0.6

Source: World Bank: *Global economic prospects and the developing countries*, 1995.

As will be discussed in subsequent chapters of the report, employment conditions have deteriorated in many parts of the world. Since 1973 unemployment rates in most industrialized countries have risen and there has been a rapid emergence of mass unemployment in the former centrally-planned economies since they began the process of transition to a market economy in 1990. In the developing countries employment conditions deteriorated in sub-Saharan Africa and Latin America during the 1980s. While there has been the beginning of a reversal of this trend in Latin America with its economic recovery, the deterioration has continued in sub-Saharan Africa due to its persistently poor economic performance.

This relatively slow growth in the world economy and the wide variation in growth rates among countries, together with the deteriorating employment conditions in many parts of the world, have given rise to several anxieties about the on-going process of globalization. In the industrialized countries there have been anxieties about job losses to developing countries through the growth of imports from, and the relocation of production to, these countries. In the transition economies and developing countries there are fears that the social costs associated with economic liberalization and the move to a market economy may be too high.

These are understandable concerns but not all of them are well founded. In the case of the industrialized countries there has been a lively debate in the academic literature over how large an impact trade with low-wage countries has had on employment. On balance, the empirical evidence suggests that trade with developing countries and the relocation of industries has been only a minor explanatory factor behind the rise in unemployment and the declining wages of unskilled workers in these countries.[3] The job loss pessimists also overlook the significant reverse benefits that are derived from trade and investment links with developing countries. The fears of the transition and developing countries over the social impact of liberalization are real enough, but this defines a problem to be dealt with rather than being an adequate justification for a recourse to greater insulation from the global economy. It is true that in many cases there will be short- or medium-term social costs from economic

liberalization, but there will also be far larger long-term gains as compared to the alternative of protectionist policies. The challenge is thus to manage the transition to a more open market economy at a pace and in a manner that minimizes social costs and that is supported by strong compensatory policies vis-à-vis those who are most adversely affected by the reforms.

To dismiss these fears is not, however, to say that globalization does not pose new challenges to policy-makers. For one thing the effectiveness of some national policies is circumscribed in important ways. For example fiscal and monetary policies have now to be more mindful of the judgement and sentiments of global financial markets. Similarly, greater openness of the economy implies that the impact of domestic policies on the international competitiveness and the external balance of an economy has now to figure as a more important consideration than hitherto.

Globalization also implies that countries are becoming more interdependent. Because of closer links through trade, investment and other financial flows all countries are now more vulnerable to adverse developments in the international economy and, by the same token, stand to benefit more from favourable developments. There should thus be a stronger stake in international cooperation to ensure a stable, open and expanding world economy. Continued growth in world trade will mean the mutually beneficial expansion of markets which will lead to higher growth of output and employment. Similarly, freer flows of foreign direct investment and other forms of capital will mean a more efficient allocation of resources and also higher growth. The adoption of this positive view of globalization is of central importance since, as will be argued in subsequent chapters, higher growth is the key to solving, or at least ameliorating, the employment problems in many countries at all levels of development. And there is no better stimulus to growth in a single country than high growth in the global economy.

But there are a number of areas where international cooperation is required to improve the outcome of the current process of globalization. One problem has been the significant number of least developed countries, especially in sub-Saharan Africa, that have been left out from the benefits of globalization. Their share of world trade has fallen, while the increasing flow of foreign direct investment and other forms of capital have bypassed them. Indeed the flow of foreign direct investment and portfolio investment has been highly concentrated in the higher-income and more successful developing countries. While the ultimate solution to this problem lies in national policies to improve the competitiveness of these countries, they will require international assistance in overcoming fundamental obstacles which currently handicap their development prospects.

Another area of concern is the risk of instability in the international financial system and the negative repercussions it has on output and employment. As noted earlier, a feature of the recent globalization of financial markets has been the rapid growth of short-term cross-border flows in foreign-exchange, bond, and equity markets. Unlike foreign direct investment which is long-term in nature, these short-term flows can be volatile. With new communications technology transaction costs are very low and adjustments in global portfolios can be done almost instantaneously. Because of imperfect information, portfolio managers can sometimes over-react and take decisions that are not related to the internal economic conditions in particular countries. This could lead to financial crises in particular countries which could have a contagious effect on other countries.

While there is no agreement on the possible solutions to this problem, it is more widely accepted that there should be continuing efforts to find ways of preventing or reducing the risk of financial crises and of resolving them more quickly and efficiently when they do occur.[4] In addition, some international facility for emergency financing for countries hit by crises would help by allowing the necessary breathing space for crisis resolution as well as limit the knock-on effects on other countries. Measures to improve the prudential regulation of markets in new financial instruments and ensure greater transparency in the financial transactions of financial institutions and governments would also be helpful. A proposal to slow down the pace of transactions in foreign exchange markets through the imposition of a universal transactions tax has received wide attention. But there have also been doubts expressed that it is not administratively feasible and may impair market efficiency.[5]

Apart from these international financial issues it will be important that all countries adhere to common rules of the game in maintaining open economic policies and refraining from policies that confer on them an unfair competitive advantage. The latter now applies not only to trade policy but also to all domestic policy issues such as competition and environmental and labour standards which affect competitiveness.

Adherence to these rules will place heavier burdens on domestic policy, but the benefits in terms of higher growth will also be greater. There will be stronger pressure to maintain sound macroeconomic policies, to eschew market distortions, and to improve allocative efficiency. In many cases this will imply economic reforms such as trade and financial liberalization, the removal of price controls and other forms of deregulation. These reforms will be beneficial for growth since they will create an incentive for resources to be allocated to activities that offer higher productivity and are more in line with a country's comparative advantage. This higher growth will in turn favour employment creation. In addition, employment creation will be enhanced by the removal of distortions such as the underpricing of capital and overvalued exchange rates, which increase the capital-intensity of production and hence reduce employment.

But, as mentioned earlier, there will be transitional costs that will have to be dealt with. Indeed one of the critical requirements for successful adaptation to a globalizing world economy is the incorporation of a strong social component into economic reform programmes. This includes measures such as the training and retraining of displaced workers, redeployment schemes, and the promotion of alternative employment opportunities. In some circumstances selective employment subsidies for low-skilled or otherwise disadvantaged workers may be necessary. Such measures are necessary not only on the grounds of equity but also because they are necessary to ensure the political acceptability and social sustainability of economic reforms.

Notes

[4] For a fuller discussion, see ILO: *World employment 1995*, pp. 32-34.

[5] ibid., pp. 35-42.

[6] ibid., and Chapter 2 of this report.

[7] "Sovereign debt: Orderly workouts", in *Centre for Economic Policy Research Bulletin*, Autumn 1995.

[8] See B. Eichengreen, J. Tobin and C. Wyplosz: "Two cases for sand in the wheels of international finance", and P. Garber and M. P. Taylor: "Sand in the wheels of foreign exchange markets: A sceptical note", in *Economic Journal*, Jan. 1995.

CHAPTER II

IS FULL EMPLOYMENT STILL RELEVANT?

Introduction

In the immediate aftermath of the Second World War the goal of full employment became a priority of economic policy. In the United Kingdom, for instance, the White Paper on Employment Policy of May 1944 committed the Government to "accept as one of their primary aims and responsibilities the maintenance of a high and stable level of employment after the war".[1] The intellectual inspiration for this was Keynes's *General theory*, published in 1936,[2] which had been a reaction to the trauma of mass unemployment during the Great Depression. A basic message of Keynes was that such mass unemployment was a preventable evil and that it was possible for economic policies to ensure full employment. He defined full employment as the point at which aggregate demand could not further increase employment and output, and in his frame of analysis it was perfectly feasible for macroeconomic policy to ensure full employment in this sense. These basic ideas were translated into the realm of practical policy through an influential book by William Beveridge, *Full employment in a free society*, published in 1944. Beveridge defined full employment as a state in which there were "more vacant jobs than unemployed men" and where there were jobs "at fair wages, of such a kind, and so located that the unemployed men can reasonably be expected to take them".[3]

In neither the Keynesian nor Beveridgian definition of full employment was this thought of as a zero rate of unemployment. For Keynes a crucial distinction was between voluntary and involuntary unemployment, and his conception of full employment was directed at the elimination of the involuntary part of unemployment. Similarly, Beveridge allowed for frictional unemployment. A certain level of unemployment was inevitable as workers released from declining activities engaged in the search for new jobs, and also for the process of matching of workers to jobs to work itself through. Hence the working definition of full employment adopted by Beveridge was an unemployment rate of 3 per cent. He envisaged that "this margin would consist of a shifting body of short-term unemployed who could be maintained without hardship by unemployment insurance".[4] It is also significant to note that an underlying argument in favour of full employment was the need to prevent the economic and social hardship associated with the mass unemployment of the Great Depression. The low level of unemployment associated with his definition of full employment would ensure that adequate social relief for the unemployed was affordable. But he also emphasized that this was not the only argument in favour of full employment; even if adequate income support could be provided for a considerably higher number of unemployed this would not make high unemployment acceptable. To him "idleness is not the same as want, but a separate evil, which men do not escape by having an income. They must also have the chance of rendering useful service and

of feeling that they are doing so."[5] Full employment was thus necessary on the grounds of what has since been termed as the income as well as the recognition aspect of employment.[6]

These ideas proved to be extremely influential. Apart from commitments to full employment at the national level, the mandates of the international organizations established after the Second World War all included references to the attainment of either a "high and stable level of employment" or full employment. In the ILO itself the Declaration of Philadelphia adopted in 1944, which redefined its mandate for the post-war world, contained a strong commitment to the pursuit of full employment.[7]

This commitment to full employment was successfully translated into reality in the immediate post-war decades. In most industrialized countries unemployment rates of 2 to 3 per cent, consistent with Beveridge's definition of full employment, prevailed until 1973. Since then, however, there has been a steady drift away from full employment. Unemployment rates have risen since then and the gap between the actual levels of employment and the full employment of the past has widened.

Not surprisingly, therefore, there has been widespread questioning of the usefulness of the concept of full employment. At the most basic level it has been argued that full employment will never again be attainable and that retaining the concept in discourse on employment is both unrealistic and dysfunctional. Unrealistic because revolutionary changes in technology and economic organization have led to the onset of "jobless growth", and new jobs will never again be created in sufficient numbers to restore full employment. And dysfunctional because it distracts attention from the fundamental changes in social and economic organization that are essential for adapting to a future where, inevitably, only part of the potential labour force will be required to work. Less drastic, but at the same time more influential at the policy level, is the view that it is futile, and even counter-productive, to retain the Beveridgian definition of full employment as an objective of economic policy, since there are no feasible policy instruments for attaining it. Attempts to tamper with the "natural rate of unemployment" to which an economy tends will invariably come to grief over the accelerating inflation that this will provoke.[8] There are, in addition to these two basic stances, other stands of "employment pessimism", such as the fear that globalization will lead to a haemorrhage of jobs from industrialized countries or the view that the structure of employment has changed so fundamentally as to make a concept of full employment based on regular jobs obsolete.

This scepticism over the usefulness of the concept of full employment, strengthened by the patent failure to achieve it in recent times, deserves careful examination at the outset of any discussion of the employment problem. If the sceptics who believe in a jobless future are right, then it would be necessary to abandon the conventional discussion of policies for reducing unemployment and to adopt instead their alternative agendas of adapting economic and social institutions to a future dearth of jobs. Similarly if the "natural rate" theorists are right, then one should not be unduly concerned about current high levels of unemployment, since this merely reflects a voluntary equilibrium in labour markets. The policy issues would also be accordingly more limited, largely confined to labour market deregulation, reform of unemployment benefit systems, and other supply-side measures which could lower equilibrium levels of unemployment. Much more is therefore at stake than a simple quibble over the concept of full employment. There is in addition a special ILO angle

to the issue. The Employment Policy Convention (No. 122), adopted in 1964 and currently ratified by 80 countries, calls upon member States, "with a view to stimulating economic growth and development, raising levels of living, meeting manpower requirements and overcoming unemployment and underemployment", to "declare and pursue, as a major goal, an active policy designed to promote full, productive and freely chosen employment". The Convention requires that employment policy should be implemented within the framework of a coordinated economic and social policy and that representatives of the persons affected by the measures to be taken, and in particular representatives of employers and workers, shall be consulted "with a view to taking fully into account their experience and views and securing their full cooperation in formulating and enlisting support for such policies."[9]

It is therefore important to begin with a critical evaluation of the empirical basis for the main criticisms of the concept of full employment.

THE END OF WORK?

A number of recent books and papers have attracted popular attention by playing on the old fear of technological unemployment. Indeed, the theme of the "end of work" has attracted the attention of writers from a variety of disciplines — philosophers, economists, sociologists, and management specialists. This is, of course, only a limited strand of a broad and complex literature on the impact of technology on employment[10] but it is important to confront it because it poses a fundamental challenge to the concept of full employment and has had an impact on popular thinking on the subject.

Some writers have addressed what they believe to be a fundamental feature of "post-industrial" societies, namely the onset of "jobless growth" with the passing of the Fordist mode of production.[11] They envisage a future social system in which there will be expanded scope for personally satisfying non-market activities (private or public, individual or social) as the economic imperative to engage in paid employment declines with rising productivity. Rising prosperity will make it possible to pay for both sides of human activity: while work will continue to be paid for by firms, self-oriented non-market activities will be rewarded through a "second cheque" from the State. This utopian perspective of the "liberation from work" has been aptly dubbed as "computopia".

Alongside this there has been a more dismal literature playing up the fear of massive technological unemployment. A recent example of such work bases its prediction of the "end of work" on the dramatic losses that have occurred in several large United States corporations since the early 1980s.[12] It provides striking anecdotal evidence on the loss of 250,000 jobs in General Motors between 1978 and 1993, of 100,000 jobs in US Steel between 1980 and 1990, of 170,000 jobs in General Electric between 1981 and 1993, and of 180,000 jobs in AT&T between 1981 and 1988. It then makes bold extrapolations from these episodes of corporate downsizing to a catastrophic scenario of the end of work. Apart from labour displacement itself this literature also attributes a host of other labour market ills to the disruptive effects of technical change. The erosion of wage levels, the growth of precarious jobs, the rise of an underclass and social exclusion are all attributed to labour-displacing technical change.

The credibility of such sensational predictions is very limited since they are based on an invalid double generalization. On the one hand, the case of particular large corporations is proposed as representative of the whole economy; on the other, the direct labour-saving impact in production processes is proposed as the only consequence of technical change. Yet the labour-saving reorganizations in large manufacturing firms do not tell the entire story: small firms and the other sectors of production have to be taken into account as well. Similarly the analyses make no allowance for the indirect effects of technical change and the jobs that can be created by the growth of new products and industries. From a static point of view it is simple to point out the adverse impact of labour-saving innovation, but from a proper dynamic perspective all the indirect effects of innovation have to be taken into account as well.

The most direct test of whether or not there has been a decline in the quantity of work available is to examine long-term trends in the total weekly hours worked. Unlike figures based on the total number of workers employed, these figures are not distorted by changes in average working time or an increase in part-time work. Figure 2.1 depicts figures for the total weekly hours worked in eight countries for which data are available. Since the labour-saving impact of technological progress mainly occurs in the private secondary sector, the focus is on non-agricultural and non-public sectors.[13]

Figure 2.1. Total amount of weekly hours of work (base: 100 in 1980)

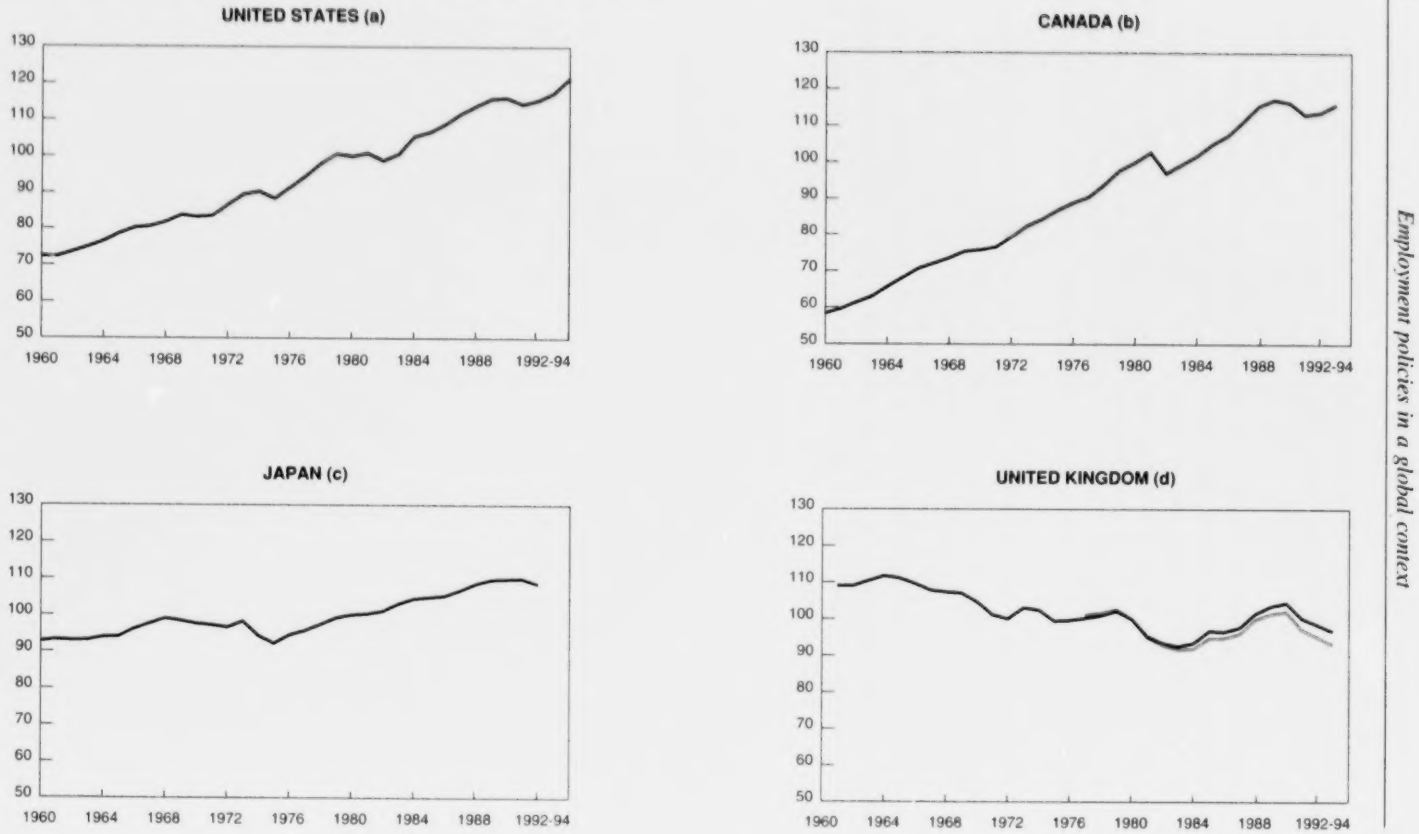
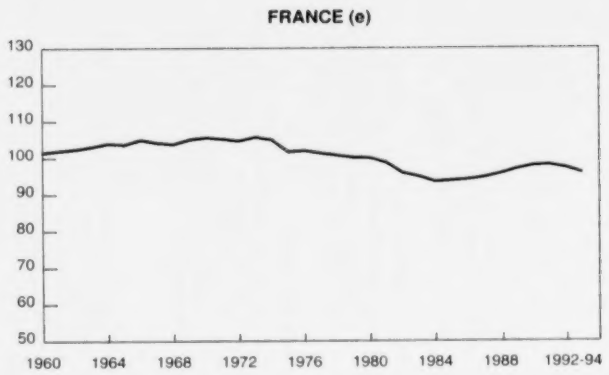
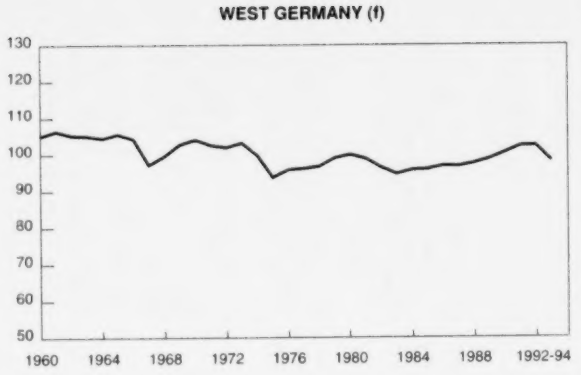
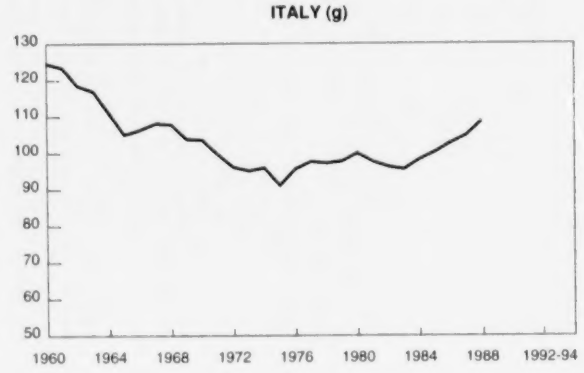
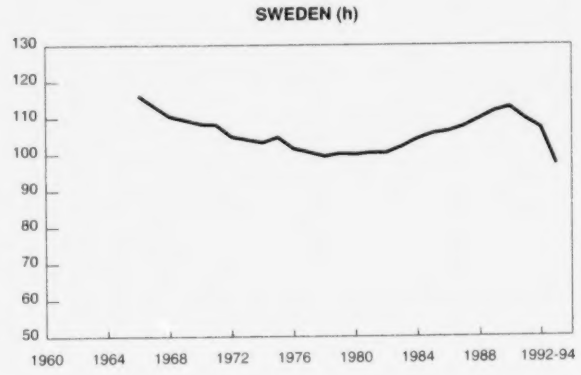


Figure 2.1. *(cont.)*









See notes overleaf.

Total amount of weekly hours of work, in thousands, except for Italy where data refer to the total amount of yearly hours of work in millions.

The total amount of weekly (or yearly) hours of work have been computed through the multiplication of the number of employed workers by the average weekly (or yearly) hours of work (except for the United Kingdom — see specific note).

(a) **United States.** Source: Bureau of Labor Statistics: *Monthly Labor Review*.

Average weekly hours of work refer to the number of hours paid to non-agricultural and non-public male and female workers, who are employed both full- and part-time. This time series includes hours actually worked during normal periods of work, overtime, and hours paid for but not worked such as paid annual vacation, paid public holidays, paid sick leave and other paid leave.

(b) **Canada.** Source: ILO: *Yearbook of Labour Statistics*.

Average weekly hours of work refer to the number of hours paid to male and female workers in manufacturing industry. This time series includes hours actually worked during normal periods of work and overtime, and hours paid for but not worked such as paid annual vacation, paid public holidays, paid sick leave and other paid leave.

(c) **Japan.** Source: ILO: *Yearbook of Labour Statistics*.

Average weekly hours of work refer to hours actually worked (including, as usual, overtime, time spent at the place of work waiting or standing by, and time corresponding to short rest periods such as tea and coffee breaks) by non-agricultural full-time and part-time employees. Part-time employees who worked less than 18 days in the last two months before the survey took place or less than 60 days in the last six months were not included. This time series does not consider hours paid for but not worked.

(d) **United Kingdom.** Source: Central Statistical Office: *Annual Abstract of Statistics* and *Employment Gazette*.

(1) Two time series are shown. The more time-extended one corresponds to the sum of the total weekly hours worked by male workers and the total weekly hours worked by female workers, without any distinction between part-time and full-time employees. The two addenda in the sum have been computed through the multiplication of average weekly hours of work per male and female (separately considered) employee by the number of, respectively, male and female employed workers. The other time series tries to take into account the increasing importance of part-time workers in employment as a whole. It corresponds to the sum of total hours worked by full-time employees (computed through the multiplication of average weekly hours of work per full-time male and female employee by the number of, respectively, male and female full-time employed workers) and the total hours worked by part-time employees (computed through the multiplication of the average weekly hours of work per part-time male and female worker by the number of, respectively, male and female part-time employed workers). Because of the lack of available data, the latter has been computed on the basis of two assumptions:

(i) average weekly hours of work per part-time employee is half the average weekly hours worked by a full-time employee;

(ii) during the period 1977-84, the rate of change of the number of part-time male workers has been equal to that of female workers.

(2) Average weekly hours of work refer to the number of hours actually worked (including overtime) by non-agricultural full-time workers on adult rates of pay. Male and female workers are separately considered. People employed in the following divisions of economic activity are excluded: coal mines, commerce, railways, financing, insurance, real estate and business services. This time series does not consider hours paid for but not worked. In 1980 a change in the surveyed workers' requirements causes a slight discontinuity along the time series.

(3) The available number of part-time male and female workers refers to Great Britain and not to the entire United Kingdom.

(e) **France.** Source: ILO: *Yearbook of Labour Statistics*; OECD: *Economic Outlook*.

Average weekly hours of work refer to the number of hours actually worked (including overtime) by non-agricultural male and female workers. People employed in the following divisions of economic activity are excluded: water, communication, public administrations and private domestic services. This time series does not consider hours paid for but not worked.

(f) **West Germany.** Source: Statistisches Bundesamt: *Wirtschaft und Statistik*.

Average weekly hours of work refer to the number of hours paid to male and female workers employed in the following divisions of economic activity: mining and quarrying; manufacturing; electricity, gas and water; construction. Other major divisions such as commerce, transport, financing, insurance, real estate and business services, public administrations and services are not taken into account. This time series includes hours actually worked during normal periods of work, overtime, and hours paid for but not worked such as paid annual vacation, paid public holidays, paid sick leave and other paid leave.

(g) **Italy.** Source: Italian National Statistical Institute (ISTAT).

Average yearly hours of work refer to hours actually worked (including overtime) by industrial male and female employees. This time series does not consider hours paid for but not worked.

(h) **Sweden.** Source: Statistik Arsbok; ILO: *Yearbook of Labour Statistics*.

Average weekly hours of work refer to hours actually worked (including overtime) by non-agricultural full-time and part-time male and female workers. The time series is available since 1971.

Table 2.1. Employment, working-age population and per capita employment
(average annual growth rates)

	Employment growth		Working-age population growth		Per capita employment growth	
	1960-73	1974-95	1960-73	1974-95	1960-73	1974-95
United States	2.0	1.8	1.7	1.1	0.3	0.7
EC 12[1]	0.3	0.2	0.6	0.6	– 0.3	– 0.4
Former EFTA	0.5	0.3	0.7	0.5	– 0.1	– 0.2
Japan	1.3	0.9	1.7	0.7	– 0.4	0.2
Canada	3.3	1.9	2.3	1.5	1	0.4
France	0.7	0.2	1.1	0.7	– 0.4	– 0.5
Germany[2]	0.3	1.2	0.4	1.6	– 0.1	– 0.4
United Kingdom	0.3	0.1	0.2	0.3	0.03	– 0.2
Italy	– 0.4	0.3	0.6	0.5	– 0.9	– 0.2
Spain	0.8	– 0.3	0.8	1	– 0.1	– 1.3
Portugal	0.02	1.1	– 0.6	1	0.6	0.1
Greece	– 0.5	0.8	0.3	1	– 0.8	– 0.2
Belgium	0.6	0.01	0.4	0.4	0.3	– 0.4
Netherlands	0.9	0.9	1.5	1	– 0.6	– 0.2
Ireland	0.09	0.6	0.5	1.1	– 0.4	– 0.5
Denmark	0.9	0.3	0.7	0.4	0.2	– 0.1
Switzerland	1.5	0.1	1.2	0.5	0.2	– 0.4
Austria	– 0.3	0.6	0.1	0.7	– 0.4	– 0.03
Sweden	0.5	0.1	0.5	0.3	0.01	– 0.2
Finland	0.2	– 0.2	1	0.4	– 0.7	– 0.6
Norway	0.7	1	0.7	0.6	0.03	0.4
Iceland	2.2	1.6	1.8	1.3	0.4	0.2
Australia	2.4	1.6	2.2	1.6	0.2	– 0.03
New Zealand	2.2	0.9	2	1.2	0.2	– 0.3

[1] EC 12 excludes the Lander of the former German Democratic Republic. [2] Up to 1990 data refer to West Germany; thereafter, they refer to the whole of Germany.

Source: OECD: *Economic Outlook*, June 1995, and reference supplement.

As can easily be seen, in Canada, Japan and the United States there has been a clear tendency for the total demand for working time to increase, while the five European countries (France, Italy, Sweden, West Germany and the United Kingdom) show either stable or decreasing trends. This preliminary empirical evidence thus suggests that, after the Second World War, the compensation effects of technology have been more than fully effective in North America and Japan while in Europe there is a slow tendency towards the saving of labour.

Turning to the rate of employment growth, it will be seen in table 2.1 that this has remained almost unchanged over the last three-and-a-half decades. In particular, the rate of employment growth has not significantly slowed down since 1973. Hence, far from reflecting a decline in the amount of work provided, the rise in European unemployment is largely related to the fact that employment growth lagged behind labour force growth (tables 2.1 and 2.2).[14] This steadiness of employment growth over the whole period from 1960 to 1995 thus does not support the view that jobs are inexorably disappearing.

Table 2.2. Labour force growth and trend in participation rates

	Labour force average annual growth rate		Total participation rate			Male participation rate		Female participation rate	
	1960-73	1974-95	1960	1973	1995	1973	1993	1973	1993
United States	1.9	1.8	64.5	66.6	77.5	86.2	84.9	51.1	69.1
EC 12[1]	0.3	0.7	67.5	65.5	65.7	88.8	77.6	44.9	55.5
Former EFTA	0.5	0.6	73.8	72.4	74.0	88.2	82.6	56.1	66.2
Japan	1.3	1	75.7	71.7	76.5	90.1	90.2	54.0	61.8
Canada	3.1	2.1	60.5	67.6	76.1				
France	0.8	0.7	70.3	67.8	67.6	85.2	74.5	50.1	59
Germany[2]	0.3	1.6	69.8	69.2	68.5	89.6	78.6	50.3	61.4
Great Britain	0.3	0.4	72.3	73	74.4	93	84	53.2	65.3
Italy	– 0.3	0.5	65.2	58.1	58.1	85.1	74.8	33.7	43.3
Spain	0.8	0.8	60.6	60.1	58.3	92.9	74.5	33.4	42.8
Portugal	0.1	1.4	58.2	63.6	68.5		82.5		61.3
Greece	– 0.8	1.2	65.8	57.1	59.2	83.2	73.7	32.1	43.6
Belgium	0.5	0.5	60.8	62.2	63.9				
Netherlands	1	1.1	64.4	60.5	61.8				
Ireland	0.1	1	67.3	63.5	62.1				
Denmark	0.9	0.7	74	75.3	81.1	89.6	82	61.9	78.3
Switzerland	1.5	0.3	75.3	77.4	74.1				
Austria	– 0.4	0.8	72.1	67.8	69.8		92.5	54.1	57.9
Sweden	0.6	0.4	74.7	75.2	77.1	83	80.8	48.5	58.9
Finland	0.3	0.5	77.1	70.7	73.1	88.1	79.3	62.6	75.7
Norway	0.7	1.1	68.7	68.7	77.3	80	77.6	63.6	70
Iceland	2.2	1.7	67.9	71.3	78.3	86.5	82	50.6	70.8
Australia	2.5	1.9	67.5	69.9	74.3				
New Zealand	2.2	1.3	63.1	64.6	65.6				

[1] EC 12 actually excludes the Lander of the former German Democratic Republic. [2] Up to 1990 data refer to West Germany; thereafter, they refer to the whole of Germany.

Source: OECD: *Economic Outlook*, June 1995, and reference supplement.

This is confirmed by data on the job content of growth. Technical progress can only be said to be labour-saving if, for a given rate of growth of the production, employment growth is reduced. It has been claimed that this has in fact occurred. "Many parts of the world are witnessing a new phenomenon — jobless growth. Even when output increases, increase in employment lags way behind."[15] Contrary to this claim, the data (presented in table 2.3) show that, instead of becoming "jobless", growth has in fact become more job-intensive; the pace of job creation has remained steady in the face of the sharply reduced rate of economic growth in the 1970s and 1980s. In addition, the data also show that the *relative* capacities of American and European economies to create employment have not been affected since 1973. It will also be seen that, while an annual growth of 2 per cent was required for the economy to start creating employment in the United States before the oil shock (compared with a growth of 4.3 per cent in Europe), new jobs are now being created as soon as growth reaches 0.6 per cent (2.0 per cent in Europe).

The debate on jobless growth has been centred on the industrialized countries. The structure and nature of employment in developing countries is very different from that

Table 2.3. GDP and employment growth

A. Industrialized countries

	GDP growth		Employment growth		Growth required for the economy to start creating jobs	
	1960-73	1974-95	1960-73	1974-95	1960-73	1974-95
United States	4.0	2.4	2.0	1.8	2.0	0.6
EC 12[1]	4.6	2.2	0.3	0.2	4.3	2.0
Former EFTA	4.5	1.9	0.5	0.3	4.0	1.6
Japan	9.4	3.3	1.3	0.9	8.1	2.4
Canada	5.4	3.0	3.3	1.9	2.1	1.1
France	5.4	2.2	0.7	0.2	4.7	2
Germany[2]	4.4	2.6	0.3	1.2	4.1	1.4
United Kingdom	3.2	1.8	0.3	0.1	2.9	1.7
Italy	5.3	2.4	– 0.4	0.3	5.7	2.1
Spain	7.3	2.4	0.8	– 0.3	6.5	2.7
Portugal	6.9	2.7	0.02	1.1	6.88	1.6
Greece	7.7	2.1	– 0.5	0.8	8.2	1.3
Belgium	4.9	2	0.6	0.01	4.3	1.99
Netherlands	4.8	2.2	0.9	0.9	3.9	1.3
Ireland	4.4	4.2	0.09	0.6	4.31	3.6
Denmark	4.2	1.9	0.9	0.3	3.3	1.6
Switzerland	4.5	1.2	1.5	0.1	3	1.1
Austria	4.7	2.4	– 0.3	0.6	5	1.8
Sweden	4.1	1.5	0.5	0.1	3.6	1.4
Finland	4.9	2.1	0.2	– 0.2	4.7	2.3
Norway	4.3	3.4	0.7	1	3.6	2.4
Iceland	5.5	3.3	2.2	1.6	3.3	1.7
Australia	5.1	3.0	2.4	1.6	2.7	1.4
New Zealand	3.6	1.6	2.2	0.9	1.4	0.2

[1] EC 12 actually excludes the Länder of the former German Democratic Republic. [2] Up to 1990 data refer to West Germany; thereafter, they refer to the whole of Germany.

Source: OECD: *Economic Outlook*, June 1995, and reference supplement.

in industrialized countries, with only a very small minority of the labour force, if at all, being employed in activities using the latest technologies. Technological displacement of labour, in the sense in which it has been discussed in the industrialized countries, is thus not a major issue although, as will be discussed in Chapter V, there are other problems of labour displacement associated with economic reform programmes. As can be seen in panel B of table 2.3, there is no evidence that "jobless growth" is a problem in the countries and areas for which the relevant data are available. In countries which have experienced low rates of growth of GDP the employment elasticities have been very high, indeed above unity. This indicates negative growth in labour productivity, raising a very different set of problems from that of jobless growth. In the rapidly growing economies of East and South-East Asia the employment elasticities are lower, ranging from 0.29 in Indonesia to 0.56 in Malaysia. But it will also be seen that employment growth has been very high; except in Indonesia it has exceeded the rate of growth of the labour force. This has led to declining unemployment and tight labour markets, as well as rapidly increasing real

Table 2.3 *(cont.)*

B. Developing countries and areas

	GDP	Employment	Employment elasticities	Manufacturing value added	Manufacturing employment	Employment elasticities
	1975-94[1]	1975-94[1]	1975-94	1975-92	1975-92	1975-92
Bolivia	0.74	1.33	1.81	n.a.	n.a.	n.a.
Venezuela	2.08	3.98	1.91	n.a.	n.a.	n.a.
Philippines	2.77	3.16	1.14	6.44	4.50	0.70
Brazil	2.85	3.64	1.27	3.18	2.97	0.93
Panama	3.48	3.74	1.07	1.60	1.82	1.14
Colombia	4.13	4.67	1.13	4.14	0.58	0.14
India	4.93	2.01	0.41	5.70	1.50	0.26
Chile	5.43	3.35	0.62	5.29	2.35	0.45
Malaysia	6.03	3.40	0.56	11.10	7.39	0.67
Indonesia	6.26	1.83	0.29	15.64	8.90	0.57
Pakistan	6.33	2.38	0.38	n.a.	n.a.	n.a.
Hong Kong	7.03	2.33	0.33	5.61	0.83	0.15
Singapore	7.54	3.60	0.48	9.54	3.98	0.42
Thailand	7.91	3.39	0.43	7.07	3.69	0.52
Korea, Republic of	8.57	2.74	0.32	12.48	4.91	0.39

[1] The figures for GDP and total employment correspond to: Bolivia: 1976-90; Brazil: 1976-90; Chile: 1975-94; Colombia: 1975-94; Panama: 1975-92; Venezuela: 1975-93; India: 1975-89; Indonesia: 1976-92; Hong Kong: 1979-93; Republic of Korea: 1975-93; Malaysia: 1980-90; Pakistan: 1975-92; Philippines: 1975-93; Singapore: 1979-93; Thailand: 1975-91.

Developing countries and areas are organized according to GDP growth in ascending order.

n.a.: not available.

Sources: ILO: *Yearbook of Labour Statistics*; World Bank: world tables 1995; UNIDO: industrial statistics 1994; ECLAC: *Panorama Económico de America Latina, 1995*; IMF: *World Economic Outlook*, May 1995 (estimates for 1994).

wages made possible by the very rapid rates of growth of labour productivity. Thus even in the rapidly industrializing developing countries there has been no apparent problem of jobless growth. This is confirmed by the data on employment elasticities in the manufacturing sector. These show that, except in Hong Kong, the employment elasticities in the manufacturing sector have been close to or higher than overall employment elasticities in the newly industrializing economies of East and South-East Asia. Far from being "jobless", therefore, rapid manufacturing growth in these economies has been labour intensive.

Another way of evaluating the responsiveness of employment to growth is to estimate the employment-to-GDP elasticity. Table 2.4 shows the results of cross-section regressions run between GDP growth and various measures of employment growth, over two medium-term periods (1975-82 and 1982-93). These calculations show that differences in GDP performances, which were closely related to differences in employment growth between 1975 and 1982, still matter in the subsequent period. In the 1975-82 period every percentage point of GDP increase translated into 0.49 per cent employment growth. In the 1982-93 period the elasticity even increased to 0.63. These results suggest that the growth-employment relationship has not been fundamentally altered in the last decade.

Nevertheless, even though the growth-employment relationship does not appear to have weakened in the long run, the recent period has seen growing concerns being raised about a "jobless recovery". These worries have been generated by the fact that

Table 2.4. Long-term relationship between employment and GDP growth

Period of estimation	Dependent variable: Average annual growth rate		
	Employment	Private employment	Total hours worked
1975-82	0.49	0.62	0.62
	(2.0)	(2.1)	(2.2)
1982-93	0.63	—	—
	(2.5)		

Note: The figures are the results of a regression between the average annual growth rate in GDP (independent variable) and the average annual growth rates of the listed dependent variables. The figures in parenthesis represent the T ratio. Coefficients are significant if the T ratio is above 1.96. Data are not available for private employment and total hours worked for the recent period. The countries covered are Austria, Belgium, Canada, Denmark, Finland, Federal Republic of Germany, Ireland, Italy, Japan, Netherlands, Norway, Spain, Sweden, United Kingdom and the United States.

Source: A. Boltho and A. Glyn: "Can macroeconomic policies raise employment?" in *International Labour Review, Special issue: Employment policy in the global economy*, 1995/4-5, pp. 451-470.

the present upswing has not led to a significant reduction in unemployment rates, thus suggesting weakened employment creation.

As shown in table 2.5 for most of the countries under review, the present recovery has been weaker than the previous one. The response of employment to GDP growth has also been somewhat weaker: while 1 per cent of GDP growth translated into 0.5-0.6 per cent growth in employment in the mid-eighties, it now generates only 0.2-0.3 per cent job growth. But this figure, although lower, has remained positive,[16] and thus does not support the "jobless growth" diagnosis. This lower elasticity can either be ascribed to a slow-down in the speed of adjustment of employment to GDP, in which case the "employment gap" of the present recovery will be compensated in the forthcoming quarters, or be taken as a first indicator of an ongoing long-term change in the employment-growth relationship. But, in any case, this second proposition can only remain a hypothesis as long as the stability of the relation has not been verified over a longer period. And the magnitude of the reduction in elasticity remains small.

Thus the aggregate data do not provide any support for the imminent "end of work" or even the beginnings of jobless growth. This weakens the need to take very seriously the various proposals for societal re-engineering that is often prescribed in the literature. While such proposals can be useful in opening minds and in exploring new institutional set-ups, they do not help distinguish between what is implementable in the short run and what is a more ambitious historical aim. The literature thus gives an impression of conveying "common sense" derived from a realistic analysis of actual phenomena such as corporate downsizing but in fact suggests nothing more than utopian changes which cannot be translated into actual measures of economic policy. Such policies need both a financial effort and public consent, two prerequisites of serious policy proposals which are generally over-simplified in this literature.

Delinking income from work?

A case in point is the notion, central to the end-of-work literature, that the only solution to the dearth of jobs is to delink income from work. The government should provide a basic income to all citizens and this would allow them to choose freely between traditional full-time work, part-time work, occasional spells of work,

Table 2.5. Comparison of the speed of employment adjustment in the last two recoveries

Country and period since last trough	Number of quarters since last trough	GDP growth	Employment growth	Apparent elasticity	Evolution of the apparent elasticity
Australia					
1991 Q2–1994 Q4	14 quarters	3.8	1.0	0.26	Decrease
1983 Q1–1986 Q3		5.2	3.0	0.58	
Canada					
1991 Q1–1994 Q4	15 quarters	2.8	1.1	0.39	Decrease
1982 Q4–1986 Q3		5.2	2.9	0.56	
Finland					
1993 Q2–1994 Q4	6 quarters	3.8	0.4	0.11	Decrease
1981 Q1–1982 Q3		3.8	0.9	0.24	
France					
1993 Q1–1994 Q4	7 quarters	2.3	0.3	0.13	Increase
1984 Q2–1986 Q1		2.2	0.1	0.05	
Germany[1]					
1993 Q1–1994 Q4	7 quarters	2.1	– 1.0	– 0.48	Decrease
1982 Q4–1984 Q3		3.0	– 0.3	– 0.10	
Italy					
1993 Q3–1994 Q4	5 quarters	3.1	– 1.4	– 0.45	Decrease
1982 Q3–1983 Q4		2.1	0.5	0.24	
Japan					
1992 Q3–1994 Q4	9 quarters	0.3	0.1	0.33	Increase
1983 Q2–1985 Q3		4.6	0.7	0.15	
Spain					
1993 Q2–1994 Q4	6 quarters	2.1	– 0.3	– 0.14	Increase
1981 Q1–1982 Q3		1.4	– 1.5	– 1.07	
Sweden					
1993 Q1–1994 Q4	7 quarters	2.6	– 1.0	– 0.38	Decrease
1983 Q1–1984 Q4		4.4	0.8	0.18	
Switzerland					
1993 Q2–1994 Q4	6 quarters	2.1	– 1.0	– 0.48	Decrease
1982 Q4–1983 Q2		3.0	0.5	0.23	
United Kingdom					
1992 Q1–1994 Q4	11 quarters	2.7	– 0.3	– 0.11	Constant
1981 Q2–1984 Q1		3.0	– 0.3	– 0.10	
United States					
1991 Q1–1994 Q4	15 quarters	3.1	1.3	0.42	Decrease
1982 Q3–1986 Q2		4.3	2.5	0.58	

[1] Up to 1990 data refer to West Germany; thereafter, they refer to the whole of Germany.
Source: OECD: *Employment Outlook*, 1995, Chapter 1, and ILO calculations.

non-market activities undertaken for personal satisfaction or a cause, or leisure pure and simple. The upshot would be reduced competition for scarce jobs and overall welfare would be increased through a better match between personal preferences for different amounts and type of work and the actual allocation of work.

The underlying assumption for these proposals is that the economy is sufficiently productive to pay for these arrangements and that it will remain so in spite of delinking

income from work. This presupposes that new technologies have ushered in a new age of abundance which can easily finance the delinking of income from work. However, the reality is that the high current unemployment is largely the result of slower growth of output and productivity rather than of the labour-displacing effects of hyper-productive new technologies. Thus, unless there is an imminent switch to higher growth as a result of new technologies, the proposal to delink income from work will face a serious problem of financial sustainability.

Another potential difficulty is that a guaranteed income delinked from the need to work would alter the functioning of the labour market in a fundamental way. For example, the incentive to work would be greatly weakened, if the unconditional basic income is set at a generous level. There would thus be no certainty that the required number of workers, albeit significantly reduced, could be mobilized to do the necessary work in the economy. It has been argued that social pressures would be sufficient to make people work without much economic incentive. But industrialized countries are large, relatively anonymous societies in which people form their own sub-cultures. Under a basic income scheme the work-shy are likely to form their own sub-culture and thus insulate themselves from social pressures to work. This tendency will be reinforced if shirking is destigmatized and treated as a legitimate lifestyle choice. The upshot is likely to be that growing numbers of the population stop working altogether. Some might perform unpaid useful tasks but there is no guarantee that they would do so on the required scale.

Similarly, with a weakening of the income incentive, the allocation of labour between different activities will become more difficult, especially with respect to disagreeable or low-paying jobs. If this is done through administrative means, then problems of incentive incompatibility and inefficiency will arise. Moreover, in an increasingly globalized economy it is doubtful whether countries opting to delink income from work can maintain their international competitiveness. Without this the potential productive surplus to sustain a significant non-working population will be eroded.

The problem of incentives also surfaces with respect to the redistribution of income that will be essential from those who work to those who work less or not at all. Unless there is a radical change in social attitudes it is doubtful whether such a redistribution would be politically feasible. Unlike the case of involuntary unemployment, there are no compelling moral reasons here for the working part of the population to support those who choose not to work.

A REVOLUTION IN THE NATURE OF WORK?

Closely related to the literature that has just been discussed are books which herald not so much the end of work in the sense of imminent mass redundancies but the end of work as we have conventionally known it. According to these the dominant mode of employment since the industrial revolution — stable, waged employment with clear-cut job descriptions — is in imminent danger of extinction. "What is disappearing today is not just a certain number of jobs ... but the very thing itself: *the job*."[17] Its replacement will essentially be new forms of self-employment, where the individual worker will be a one-person enterprise selling a variety of labour services to a number of buyers of such services. The employer/employee distinction will largely disappear and this will have dramatic implications for the organization of work and

Table 2.6. Non-standard forms of employment

Country	Self-employment in non-agricultural sectors		Part-time employment[a]					Temporary employment	
	Share in total employment		Share in total employment			Women's share	Share of involuntary PT[b]	Share in total wage and salary employment	
	1973	1993	1973	1979	1993	1993	1993	1983	1993
United States	6.7	7.7	15.6	16.4	17.5	66.2	30.7	..	..
Canada	6.2	8.6	9.7	12.5	17.2	68.9	36.0	..	..
United Kingdom	7.3	11.9	16	16.4	23.3	84.5	15.3	5.5	5.7
Japan	14.0	10.3	13.9	15.4	21.1	67.7	9.2	10.3[c]	10.8[d]
Australia	9.5	12.9	11.9	15.9	23.9	75.3	32.4	..	..
New Zealand	9.5[e]	15.7	11.2	13.9	21.2	74.2	32.8	..	..
Germany[f]	9.1	7.9	10.1	11.4	15.1	88.6	10.9	9.9[g]	10.2
France	11.4	8.8	5.9	8.1	13.7	83.3	39.7	3.3	10.0
Italy	23.1	24.2	6.4	5.3	5.4	70.5	47.7	6.6	5.8
Denmark	9.3	7.0	..	22.7	23.3	74.9	23.5	12.5[h]	10.7
Netherlands	9.2	8.7[i]	..	16.6	33.4	75.7	17.9	5.8	10.0
Belgium	11.2	13.3[k]	3.8	6.0	12.8	89.3	33.7	5.4	4.7
Ireland	10.1	13.0[l]	..	5.1	10.8	71.7	36.3	6.1	9.0
Spain	16.3	18.7	..	..	6.6	75.6	19.6	15.6[m]	32.0
Portugal	12.7	18.2	..	7.8	7.4	66.3	25.8	13.1[n]	8.6
Greece	31.0	28.2[o]	..	..	4.3	61.6	..	16.2	9.3
Sweden	4.8	8.7	..	23.6	24.9	81.3	27.1	..	..
Austria	11.7	6.34[p]	6.4	7.6	10.1	89.7	..	..	..
Finland	6.5	9.5	..	6.7	8.6	63.1	41.1	..	..
Switzerland	..	..	..	..	28.1	82.5	..	..	..
Norway	7.8	6.2	23	27.3	27.1	80.5	..	..	..

[a] 1989 instead of 1993. [b] 1979 instead of 1973. [c] The data for 1993 refer to the whole of Germany, otherwise they refer to West Germany. [d] 1984 instead of 1983. [e] 1975 instead of 1973. [f] 1992 instead of 1993. [g] 1991 instead of 1993. [h] 1987 instead of 1983. [i] 1986 instead of 1983. [k] 1977 instead of 1973.

[l] Break in series after 1985 for the Netherlands; break in series after 1987 for Norway; break in series after 1986 and after 1992 for Sweden; break in series after 1993 for the United States. [m] Source: OECD: *Employment Outlook*, 1995, Chapter 1, and ILO calculations. [n] Source: OECD: *Employment Outlook*, 1991.

Sources. Self-employment: OECD: *Labour Force Statistics*; Part-time: OECD: *Employment Outlook*, 1995; Temporary employment: Eurostat.

social protection. Within such a framework it will obviously be necessary to rethink economic policy and objectives such as "full employment" which guide it.

There is also a stress in this literature on the positive, liberating aspects of this shift to new, fluid forms of work. There is scope for greater flexibility in scheduling work in relation to other activities since the worker is now his or her own master. It would allow life to be treated as a portfolio of activities, with a core done for basic earnings and the rest done purely for personal satisfaction or a cause.[18]

In common with the end-of-work literature much of the argument is based on unwarranted extrapolations. It is true that new forms of work have emerged such as teleworking and outsourcing of work previously done by a core, in-house workforce. Some of this outsourcing is even being done across national frontiers. But the overall magnitudes involved have to be put in perspective. Whether or not it is the wave of the future remains to be seen. In the meantime it would be prudent to examine whether aggregate statistics on changes in the structure of employment in the past two decades or more do reveal any clear trends in this direction.

The last two decades have indeed seen the emergence of "non-standard" forms of work. Among these the most important numerically have been self-employment, part-time employment and temporary work. Each of these forms deviates from the standard full-time, regular employment by one or more characteristics. They usually offer lower levels of social security coverage and employment rights than regular jobs. Part-time and temporary work are also usually associated with lower wages.

Most OECD countries have experienced an increase in at least one form of non-standard employment, although patterns and trends vary widely. Table 2.6 indicates that the share of non-standard employment has been increasing since the beginning of the 1970s, but for most countries the increase has not been as sharp as is sometimes argued. Moreover, this trend has not been universal; some countries have in fact recorded a decrease in self-employment or temporary work. It is only the increase in part-time employment that has been universal, although even here the orders of magnitude have varied widely. A striking feature is that in 12 out of the 21 countries under review, self-employment in non-agricultural sectors has been increasing faster than total employment over the last two decades. The noticeable exceptions are Japan and some European countries (Austria, Denmark, France, Germany, the Netherlands and Norway). Temporary employment, which usually accounts for the smallest part of non-standard employment, has not shown a clear upward trend, since only 5 countries out of 12 have recorded an increase in their share in wage employment between 1983 and 1993.

These increases in some categories of non-standard employment do not, however, necessarily imply a parallel demise of regular jobs. They have to a large extent been counteracted by a marked shift in the structure of employment towards higher-skilled jobs that are usually regular in nature. Table 2.7 shows that there has been a rapid growth at the top of the employment structure (among professional, technical, administrative and management personnel) while "blue-collar" employment (production workers) remained stable or even decreased. As a result, the share of "white-collar" jobs in total employment has been rising by several percentage points.[19] These tendencies have been shared broadly by all countries under review, pointing to a structural phenomenon.

Although this occupational classification is too broad to support strong conclusions, the data tend to show that the economy is generating more "good" jobs (at the top of the structure, incorporating more skills, thus better paid and probably more secure) than "bad" jobs. To some extent, a polar development is observed, with the disappearance of middle-of-the-road "blue-collar" manufacturing jobs and the simultaneous creation of good and bad jobs.

Nevertheless, none of the above data show whether job changes are becoming more frequent or that employment is becoming more unstable. If a "job for life" has ceased to exist, and if job moves have become increasingly frequent, the figures on job tenure (or the length of continuity of employment with a single employer) estimated for the entire economy should show a significant decline.

But the striking feature of table 2.8 is the broad stability of indicators of job tenure over time. Only in the Netherlands and Spain does tenure show a sharp decrease (by 1.9 years and 1.4 years respectively between 1985 and 1991). In most countries it has been stable or even increasing. France, Germany and the United Kingdom experienced a slight decrease (of 0.4 to 0.7 years). Moreover, for many of these countries it is likely that the changes in job tenure in the 1990s reflect cyclical

Table 2.7. Employment by occupation

Occupation	Share in total employment			Average annual growth rate	
	1970	1984	1991	1970-91	1984-91
United States					
Professional, technical and related workers	14.2	15.7	17.0	0.9	1.2
Administrative and managerial workers	10.5	11.0	12.8	0.9	2.2
Clerical and related workers	17.4	15.9	15.7	-0.5	-0.2
Sales workers	6.2	12.0	11.9	3.2	-0.0
Service workers	12.4	13.5	13.7	0.5	0.2
Agricultural workers	4.0	3.4	3.0	-1.4	-2.1
Production and transport workers, labourers	35.3	28.5	26.0	-1.5	-1.3
Total	100.0	100.0	100.0		
Canada[1]					
Professional, technical and related workers	14.5	16.4	18.2	1.1	1.5
Administrative and managerial workers	5.7	10.7	13.5	4.2	3.3
Clerical and related workers	16.7	17.2	16.4	-0.1	-0.6
Sales workers	10.7	9.5	9.7	-0.5	0.2
Service workers	11.9	13.6	13.3	0.5	-0.4
Agricultural workers	6.5	5.4	4.4	-1.8	-2.9
Production and transport workers, labourers	33.9	27.1	24.5	-1.5	-1.4
Total	100.0	100.0	100.0		
Japan					
Professional, technical and related workers	5.8	9.2	11.5	3.3	3.3
Administrative and managerial workers	2.6	3.7	4.0	2.0	1.0
Clerical and related workers	14.8	17.7	18.9	1.2	1.0
Sales workers	13.0	15.1	14.8	0.6	-0.3
Service workers	7.6	8.5	8.7	0.6	0.2
Agricultural workers	17.3	8.7	6.7	-4.4	-3.8
Production and transport workers, labourers	38.7	36.7	35.0	-0.5	-0.7
Workers not classifiable by occupation	0.2	0.3	0.4	4.8	2.9
Total	100.0	100.0	100.0		
Average of 12 European countries[2]					
Professional, technical and related workers		14.5	16.7		2.0
Administrative and managerial workers		3.5	3.1		-1.4
Clerical and related workers		17.3	19.3		1.6
Sales workers		9.4	9.5		0.2
Service workers		12.0	11.6		-0.5
Agricultural workers		7.8	5.1		-5.8
Production and transport workers, labourers		34.2	32.2		-0.8
Workers not classifiable by occupation		1.4	2.4		7.7
Total		100.0	100.0		

[1] Share in total employment, 1973 instead of 1970; average annual growth rate, 1973-91 instead of 1970-81. [2] Austria, Belgium, Germany, Denmark, Spain, Finland, Greece, Ireland, Netherlands, Norway, Portugal and Sweden. Estimation for 1984 for Belgium, Netherlands and Portugal. Up to 1990 data refer to West Germany; thereafter, they refer to the whole of Germany.

Source: ILO: *Yearbook of Labour Statistics*.

Table 2.8. Indicators of turnover and job tenure

	1979 New jobs (%)	MEJT (Years)	1985 New jobs (%)	MEJT (Years)	1989 New jobs (%)	MEJT (Years)	1991 New jobs (%)	MEJT (Years)
Australia	22.3	6.5	22.9	6.6	27.9	6.5	21.4	6.8
Canada[1]	26.2	7.3	26.6	7.6	27.3	7.4	23.5	7.8
Finland	17.0	7.8	18.4	8.4	22.2	8.0	11.9	9.0
France[1]	..	..	13.1	10.7	..	..	15.7	10.1
Germany[2]	..	..	8.5	11.1	18.2	10.3	12.8	10.4
Japan[3]	10.6	8.9	9.4	10.3	9.4	10.8	9.8	10.9
Netherlands[1]	..	..	11.7	8.9	..	..	24.0	7.0
Spain[4]	..	..	15.2	11.2	..	..	23.9	9.8
Great Britain[1]	..	..	18.0	8.3	21.5	7.8	18.6	7.9
United States[5]	29.3	6.4	28.9	6.7	29.7	6.8	28.8	6.7

MEJT: Mean Elapsed Job Tenure.

Note: New jobs are the reported fraction of workers who have less than one year of tenure.

[1] 1986 instead of 1985. [2] 1984 instead of 1985, 1990 instead of 1991; up to 1990 data refer to West Germany; thereafter, they refer to the whole of Germany. [3] 1990 instead of 1991. [4] 1987 instead of 1985, 1992 instead of 1991. [5] 1978 instead of 1979, 1983 instead of 1985, 1987 instead of 1989.

Source: OECD: *Employment Outlook*, 1993.

variations rather than permanent changes in the stability of employment. It will be seen that in most countries the percentage of new jobs created varies significantly between recessionary and recovery periods.

Long-term changes in job tenure have been analysed in detail for some countries, and these studies confirm the picture that there has been no universal trend towards a decrease in job tenure among OECD countries.[20] Data in table 2.8 show that tenure is clearly stable in the United States, where it has often been claimed that jobs have become increasingly unstable. Moreover, where tenure appears to be decreasing (mainly in the United Kingdom), it is difficult as yet to distinguish cyclical variations from a real structural change. In any case, the slight changes recorded so far do not support the view that the "jobs for life" have ceased to exist or that jobs in general have become dramatically more unstable. On the contrary, a large core of the workforce is still in stable and secure jobs, even though instability and insecurity have increased in other segments of the labour market.

It should be clear therefore that there are no convincing reasons for abandoning all thought of full employment on the grounds that revolutionary changes have taken place in either the demand for labour or in the nature of work. There have indeed been changes but these have been in the form of incremental changes which do not warrant a drastic revision of basic objectives and instruments of policy. Thus, while it has patently been more difficult to achieve and maintain full employment today, one can still discuss the causes and possible remedies for this within the framework of conventional economic and social policy and without taking on a utopian agenda.

Updating the concept of full employment

The discussion so far has shown that there are no compelling reasons to abandon full employment as a policy objective. There is no evidence that there is, or soon will be, a dearth of useful work such that full employment will no longer be attainable. But it is also true, as documented above, that there have been some significant changes in

the structure and characteristics of employment in the half century since the adoption of the objective of full employment. The question therefore arises as to whether these changes require corresponding modifications to the concept of full employment.

At a fundamental level the answer is "no". The definition of full employment as the absence of involuntary unemployment or the availability of jobs for all active jobseekers remains as valid as ever. But beyond this fundamental level other dimensions of the concept can of course be modified to take into account present-day realities.

It will be recalled that the original definition of full employment allowed for necessary frictional unemployment. In practice this turned out to yield an unemployment rate of 2 to 3 per cent as the level of full employment in most industrialized countries during the period between 1950 and 1973. But there is nothing sacrosanct about these numbers. If the level of frictional unemployment has risen in the intervening period, then it is perfectly in keeping with the original definition for the unemployment rate consistent with full employment to be also revised upwards. The argument is indeed often made that nowadays the pace of structural and technological change has become more rapid and that there is consequently more "churning" in labour markets. The necessary level of frictional unemployment has consequently risen. But there is very little direct empirical evidence for this. Indeed available indicators suggest a broadly unchanged or even decelerating structural change in most European countries in the 1980s compared to the 1970s and 1960s.

The turbulence index, a measure of the proportion of workers having moved from one (sectoral, regional or occupational) category to another, shows no clear trend over time.[21] As far as a sectoral turbulence is concerned, a downward trend has even been recorded among most European countries.[22] Similarly, the more sophisticated measures of mismatch unemployment (a related but not identical measure) do not show a clear upward trend.

Thus it is likely that frictional unemployment has not increased by much, if at all. The level of frictional unemployment is certainly significantly lower than what actual unemployment levels have been in recent times in most countries. There is thus still a considerable shortfall from full employment, a fact underlined by the high level of long-term unemployment in many European countries.

Thus the definition of full employment in terms of the overall level or quantity of employment to be aimed at does not need to be changed. This is not the case, however, with respect to other dimensions of the definition. Any definition of full employment has also to include notions of what constitutes an acceptable "job". Obviously jobs that violate basic rights such as forced labour or work in unhealthy, dangerous and exploitative conditions should not be considered acceptable. Thus merely meeting the quantitative criterion of generating a sufficient number of jobs for all jobseekers is not good enough if some of these jobs are of an unacceptable quality. This is why the ILO's Convention No. 122 speaks of "full, *productive, and freely chosen* employment" and not simply of full employment.

The original definition of full employment did of course rule out jobs which violated basic rights. Beyond this the representative job was considered to be regular, full-time work for a male breadwinner. This could probably be explained by the fact that blue-collar workers within a Fordist production system were then the model group of workers, female labour force participation was very limited, and values with respect

to gender equity were different from those of today. But all this has now changed and with it so too should the notion of the representative job underpinning the concept of full employment.

With the massive entry of women into the labour market there has been a sharp increase in part-time work. This has been an important mechanism for reconciling the demand for work with family responsibilities. At the same time technical progress, especially in information and communication technology, and concomitant changes in work organization have given rise to some new, flexible and non-standard forms of work. Changes in lifestyles and values may have also contributed to a rising preference for greater current as well as intertemporal flexibility in working arrangements. But so long as the rise of these non-standard forms of work has been consistent with the preferences and voluntary choices of workers, there is no problem in considering such jobs as valid parts of a contemporary concept of full employment. Similarly, a preference for shorter working hours and a continuation of the secular trend decline in average working hours poses no problem for the definition of full employment.

The rise in non-standard forms of work, and perhaps also in the pace of job change in some segments of the labour market, implies that the issue of employment security may need to be viewed differently in a contemporary concept of full employment. It need no longer be seen as being equivalent to security in a particular job or occupation. But this is not to say that employment security is no longer a matter of concern. Rather it points to the imperative of developing alternative mechanisms for ensuring security. A fundamental requirement is full employment itself, since this provides the "macro security" that is required to soften or counteract the effects of greater "micro insecurity". Another requirement is the provision of improved access to training and retraining, since this is a crucial means of enhancing "employability security". In the face of more frequent job changes workers have to be able to maintain their employability (or prospect of getting a job) through improving existing skills or learning new ones. Yet another requirement is that systems of work-related benefits that developed largely to cater for workers in regular, full-time jobs need to be reformed to ensure commensurate coverage for the growing numbers in non-standard employment.

Perhaps the thorniest issue in updating the concept of full employment is that of equitable access to employment opportunities. The issue has become more important recently for three main reasons. The first is the heightened competition for the fewer available jobs as a result of the past two decades of high unemployment. The second is the trend towards greater inequality in labour markets reflected in rising wage inequality, greater labour-market segmentation, and the rise in long-term unemployment. The third reason is an intensification of claims for equality along gender, ethnic and other lines.

Against this background an additional onus is placed on the concept of full employment. There must not only be a sufficient number of jobs for all the competing claimants, but these have to be equitably distributed across various groups in terms of both the quantity and the quality of jobs. Hence it is not sufficient that overall employment rates are equal across groups; it is also necessary that the groups are proportionately represented in sub-sectors of employment ranked by their relative desirability. No group should be over-represented in "bad" jobs and under-represented in "good" jobs. Similarly, there should not be a widening gap between

"job rich" and "job poor" households, that is, between two-earner and no-earner households.

This implies that measures to ensure fair equality of opportunity in the labour market have to accompany policies for raising the overall rate of growth of employment. Provided this is done, a higher rate of employment growth (and better still, one accompanied by a rising proportion of "good jobs") will be a powerful means of defusing distributive conflicts.

Notes

[1] United Kingdom, Ministry of Reconstruction: *Employment policy* (London, HMSO, 1944).

[2] J. M. Keynes: *The general theory of employment, interest and money* (London, MacMillan, 1942).

[3] W. Beveridge: *Full employment in a free society* (London, George Allen and Unwin Ltd., 1944), p. 18.

[4] ibid., p. 128.

[5] ibid., p. 20.

[6] A. K. Sen: *Employment, technology and development* (Geneva, ILO, 1975).

[7] For a discussion of the background, see E. Lee: "The Declaration of Philadelphia: Retrospect and prospect", in ILO: *International Labour Review*, No. 1994/4, pp. 467-484.

[8] See in particular M. Friedman: "The role of monetary policy", in *American Economic Review*, Mar. 1968; R. Lucas Jr.: "Unemployment policy", in idem, May 1978.

[9] The Committee of Experts on the Application of Conventions and Recommendations examines regularly governments' reports on the application of the Employment Policy Convention. Report III (4 A) to the 83rd Session of the Conference contains general comments (paragraphs 49-57) and observations concerning particular countries on concrete measures of employment policies implemented by the ratifying States.

[10] For a recent discussion see U. Efendioglu, C. Freeman and L. Soete: "Diffusion and the employment effects of information and communication technology", in *International Labour Review*, No. 1995/4-5.

[11] G. Aznar: *Travailler moins pour travailler tous: 20 propositions* (Paris, Syros éditeur, 1993); A. Touraine: *Post-industrial society* (New York, Random House, 1971).

[12] J. Rifkin: *The end of work: The decline of the global labor force and the dawn of the post-market era* (New York, G. P. Putnam's Sons, 1995).

[13] The labour-saving impact of technology in agricultural sectors is not a feature of the last decade but rather took place in the 1950s and 1960s. The dynamics of public employment is clearly influenced by a set of factors (mainly the provision of public goods), among which technology appears as relatively minor.

[14] Note that employment and working-age population growth rates were similar before and after 1973. However, in the 1960s a slight decline in participation rates reduced the growth of the labour force, thus keeping it in line with employment growth and allowing full employment to be maintained.

[15] UNDP: *Human Development Report 1993* (New York, 1993), p. 36.

[16] In fact, in some countries the lag in the adjustment of employment is longer than the period under review (which starts from the trough), and thus apparent elasticities exhibit a negative sign. But this was already the case in the last recovery. Further, it should not be interpreted as a negative medium-term relation between employment and growth.

[17] W. Bridges: *Jobshift: How to prosper in a workplace without jobs* (London, Nicholas Brealey, 1995).

[18] C. Handy: *The age of paradox* (Boston, Harvard Business School Press, 1994).

[19] While the trend is clearly upward, it is not clearcut that the occupational structure changed faster during the 1970s and 1980s than during the previous decades. Examining data for the United States over the period 1940-1990, Murphy and Welch found that the relative demand for "white collars" has been increasing even faster between 1940 and 1970 than during the subsequent two decades. See K. N. Murphy

and F. Welch: "Occupational change and the demand for skill, 1940-1990", in *The American Economic Review* (Anaheim, California), May 1993.

[20] See for example A. Belkhodja: "Staying put: Job tenure among paid workers", in *Perspectives on Labour and Incomes*, Winter 1992, pp. 20-26, which shows an increase in job tenure in Canada between 1977 and 1991. See also T. Santamäki: "Internal labour markets in Finland", in *Nordic labour market policies and labour market research* (Copenhagen, Nordic Council of Ministers, 1990), which also shows an increase in job tenure in Finland between 1972 and 1988.

[21] R. Jackman, R. Layard and S. Savouri: "Mismatch: A framework for thought", in F. P. Schioppa: *Mismatch and labour mobility* (Cambridge University Press, 1991); G. Brunello: "Mismatch in Japan", in Schioppa, op. cit.; R. Morissete and L. Salvas-Bronsard: "Structural unemployment and disequilibrum", in *European Economic Review*, Aug. 1993, pp. 1251-1257; J. Elmeskov and M. MacFarlan: "Unemployment persistence", in *OECD Economic Studies*, No. 21, Winter 1993; R. Jackman, R. Layard and S. Nickell: *Unemployment: Macoeconomic performance and the labour market* (Oxford University Press, 1991).

[22] OECD: *The OECD jobs study: Evidence and explanation*, Part 1, "Labour market trends and underlying forces of change" (Paris, 1994), p. 15.

CHAPTER III

ACHIEVING FULL EMPLOYMENT IN THE INDUSTRIALIZED COUNTRIES

The previous chapter has argued that the concept of full employment, suitably updated, should remain as a principal objective of economic and social policy. But achieving it has arguably become much more difficult in the industrialized countries today than in the immediate postwar decades. Foremost among these difficulties is that there is no consensus in academic and policy thinking on the causes of the drift away from full employment since 1973 and, consequently, none on the policies for attaining it either. In this chapter some of the major aspects of these difficulties will be sketched out with a view to setting out the major strategic choices which lie ahead in the quest for full employment.

Main stylized facts of labour-market developments

Three major labour-market developments in the industrialized countries have been the focus of policy discussions. The first is the rise and persistence of unemployment in most European countries as opposed to the United States. The second is a broad tendency towards rising wage inequality in many countries, but which has been most pronounced in the United Kingdom and the United States. The third, related to the previous development, is the trend towards increasing polarization (not only in terms of wages but also of other conditions of employment) between primary and secondary segments of the labour market.

All these developments constitute deviations from the ideal of full employment. This is obvious in the case of rising unemployment. While less obvious, it is also arguable that the trend towards greater wage inequality and wider labour-market polarization have undermined the ideal of full employment. There is the danger that jobs at the bottom end of the labour market fall below widely held normative standards of what constitutes an acceptable job. Similarly, widening labour market inequality could be viewed as a "social bad" in its own right, breeding exclusion and eroding social cohesion. These latter observations in fact highlight a key dilemma. Is there an inevitable trade-off between the quantity and quality of employment? Specifically, can European unemployment be reduced only at the cost of going down the American route of more deregulated labour markets and greater inequality? Or is there a third way which can achieve all the ideal attributes of full employment — low unemployment, low inequality, and adequate social protection?

The response to these questions is strongly conditioned by judgements as to what the underlying causes of these labour-market developments have been. These constitute the diagnoses which determine beliefs as to what constitutes the best policy prescriptions. In what follows, the main contending views on the causes of these labour-market development will be discussed.

HIGH AND PERSISTENT UNDEREMPLOYMENT

Figure 3.1 compares unemployment levels since 1973 with the average levels recorded in the full employment period. Clearly, European countries show an increasing gap while in the United States unemployment has fluctuated more or less around the average level recorded in the 1960s.

The second set of graphs (figure 3.2) shows what could be called the other side of the coin, the trend in real wages. Real wage growth decelerated sharply in all countries after the first oil shock, but whereas it has remained positive in Europe and Japan it has stagnated in the United States. In Europe the lower growth in output since the first oil shock was accompanied by sustained labour productivity growth. Employment growth has thus been insufficient to secure low levels of unemployment while real wages grew adequately. Conversely, the sharp reduction in productivity gains in the United States has assured rapid job creation at the expense of stagnant individual earnings. But this is not necessarily an unambiguously better outcome. Low productivity and low wages in some sectors of the economy can reflect a high degree of underemployment if workers are displaced from high-productivity sectors to occupations with low productivity and low wages.[1] High unemployment, low productivity gains and stagnating real wages can all be regarded as major deviations from full employment.

There are two contrasting diagnoses of the high and persistent European unemployment. The first emphasizes structural features of the labour market that have impeded employment creation regardless of the overall macroeconomic environment. It is argued that structural unemployment has increased over time mainly because of labour market rigidities and excessive social protection. The second diagnosis sees inadequate aggregate growth since the first oil shock as the main factor responsible for poor employment creation. The increase in structural unemployment is regarded as a result of this low growth and inadequate job creation. Of course these two sets of diagnoses represent polar cases. In reality, several factors have simultaneously played a role.

There are various concepts and definitions of structural unemployment, but they all have in common the view that it reflects an equilibrium rate towards which the economic system tends. A particularly widespread interpretation of structural unemployment is to see it as the level of unemployment from which the economy cannot deviate without continuously accelerating (or decelerating) inflation. When unemployment falls below this equilibrium level, the bargaining power of workers becomes so high that they can obtain unwarranted (in relation to the productivity gains) wage increases that feed inflation. In this framework the equilibrium unemployment rate is called the NAIRU (non-accelerating-inflation rate of unemployment) and is defined as the rate of unemployment that keeps real wage increases in line with labour productivity gains.

Figure 3.3 shows the evolution of the NAIRU over time. While the estimates have been calculated with various methodologies, the results are very similar: all European countries have shown an increase in the NAIRU. The reasons for the rise in this NAIRU are crucial to the debate on the prospects for achieving full employment.

One explanation that has been advanced for the rise in NAIRU is that there has been a growing mismatch between demand and supply in the labour market. The contention has mainly been that the unbalanced structure of unemployment, affecting

Figure 3.1. Unemployment rates and average unemployment rates recorded during the full employment period

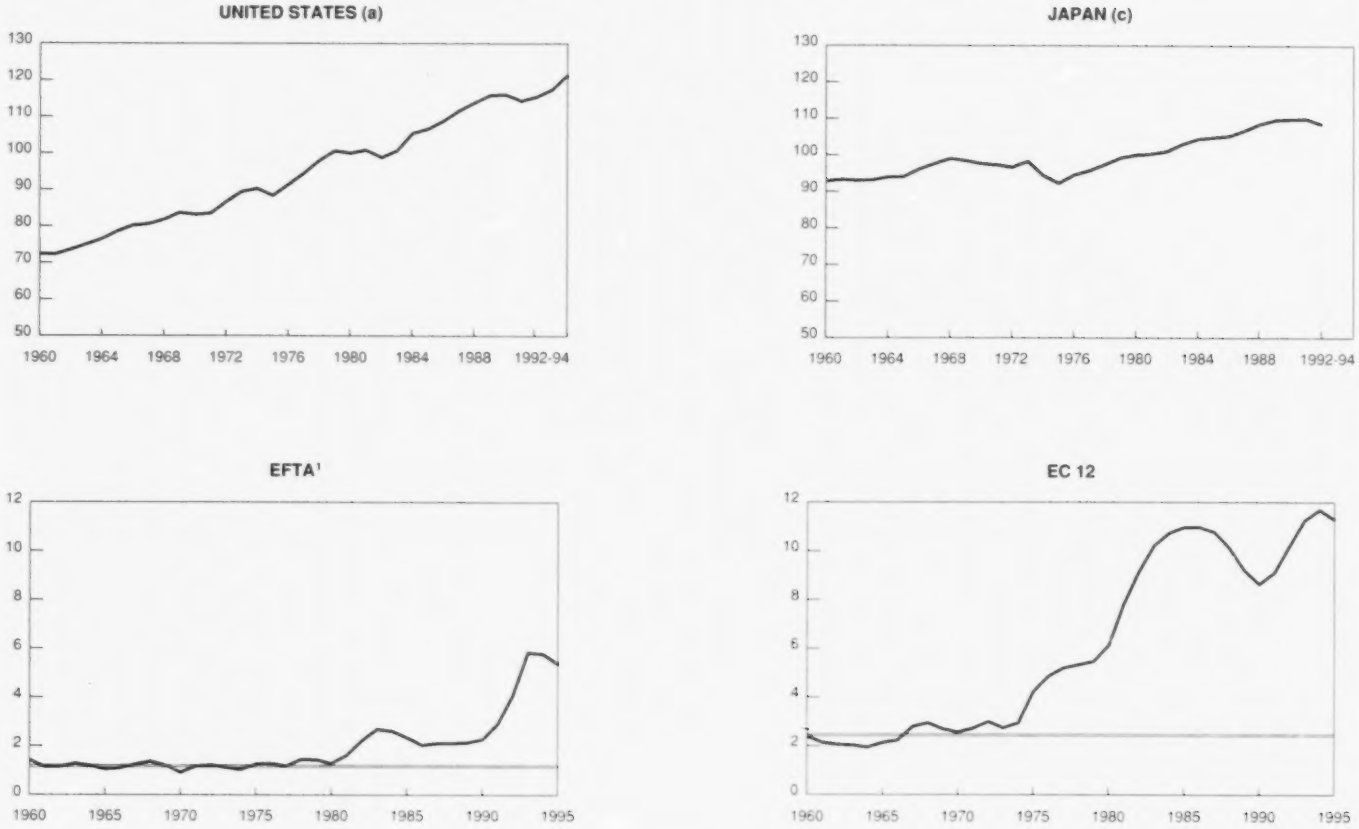
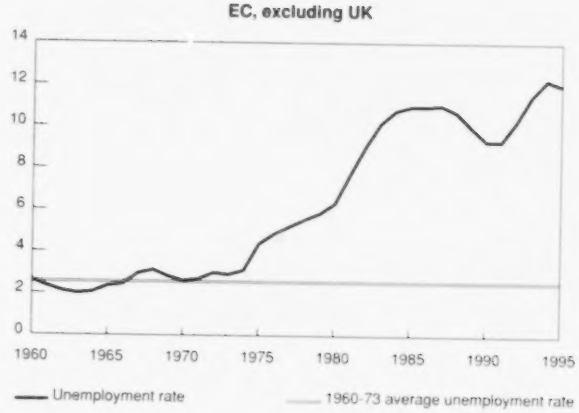
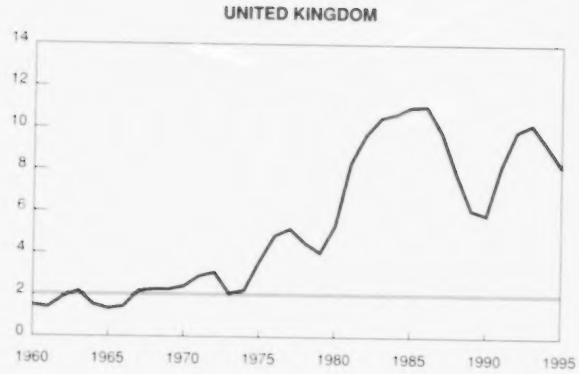


Figure 3.1. *(cont.)*





[1] The term EFTA designates only Austria, Norway, Sweden and Switzerland.

Source: OECD: *Economic Outlook* (June 1995) and reference supplement.

Figure 3.2. Actual and 1960-73 trend in real wage growth *(annual growth rates)*

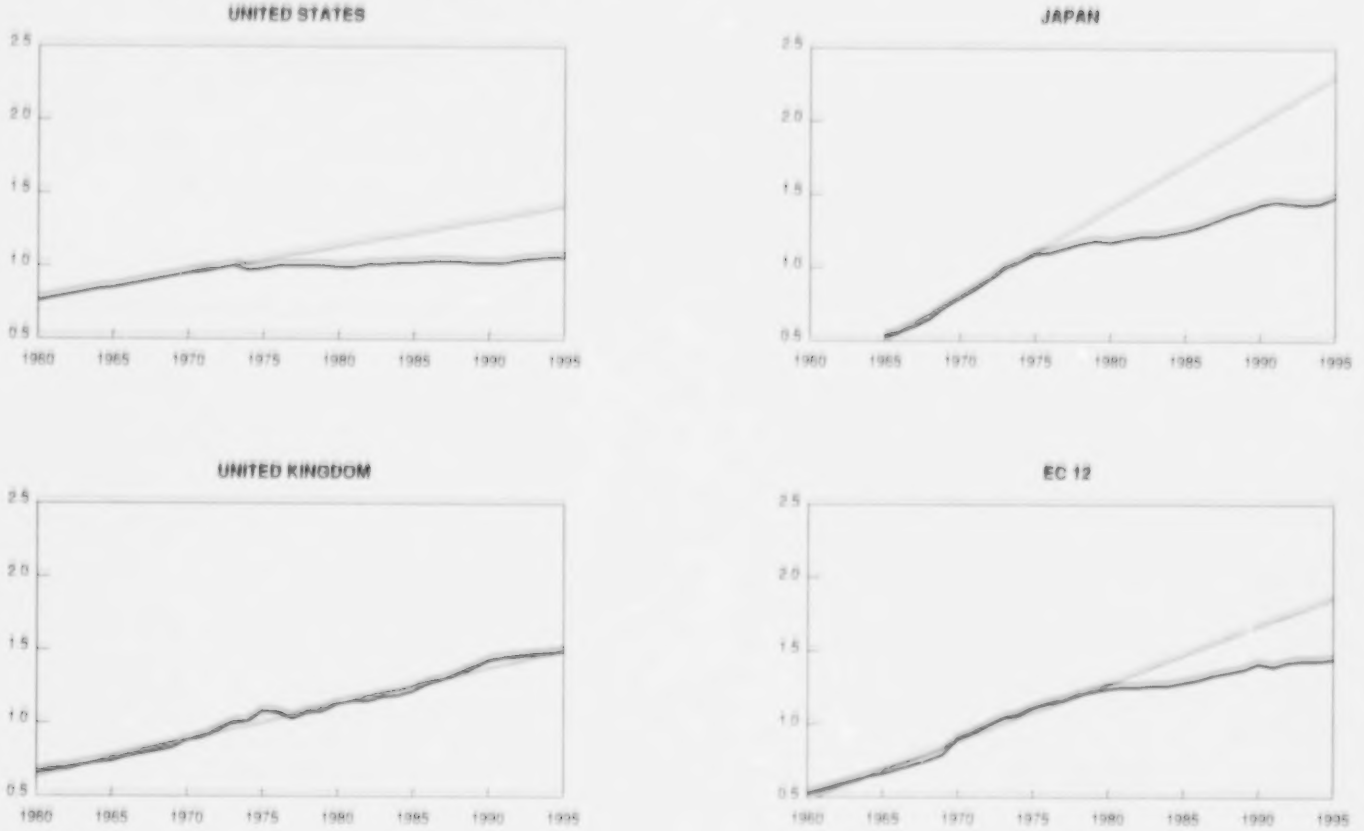
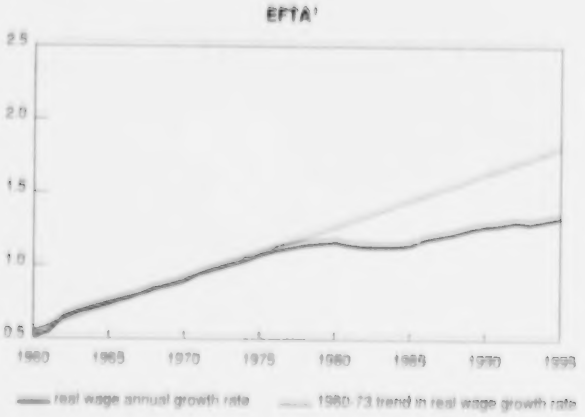
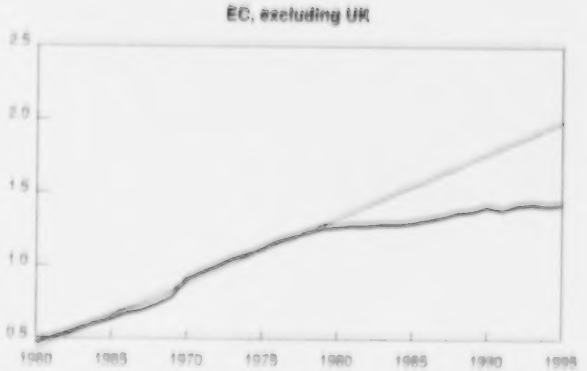


Figure 3.2. *(cont.)*





' The term EFTA designates only Austria, Norway, Sweden and Switzerland.

Source: OECD, *Economic Outlook* (June 1995) and reference supplement.

Figure 3.3. Unemployment rates and NAIRU

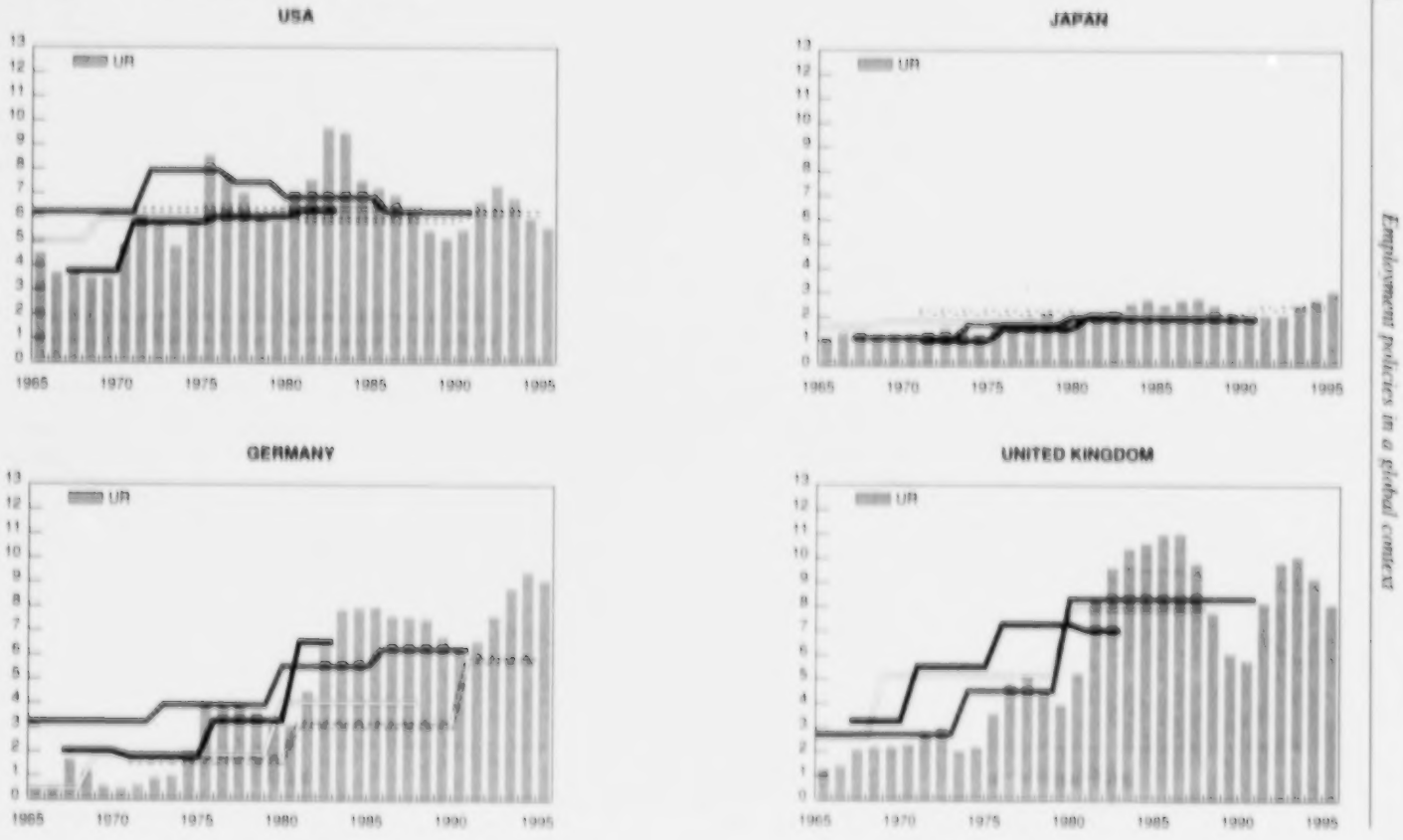
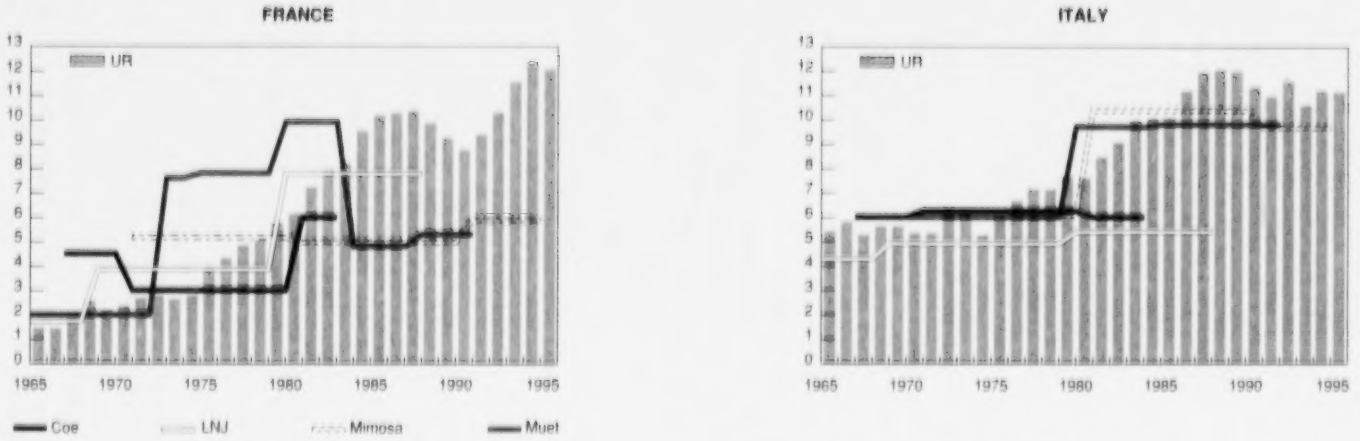


Figure 3.3. *(cont.)*



Notes: Muet: Estimation to be found in Muet (1994). Mimosa: Estimation to be found in Cepii (1992). LNJ: Estimation to be found in Layard, Nickell and Jackman (1991).
Coe: Estimation to be found in Coe (1985).

Source: UR: Unemployment rate taken from OECD: *Economic Outlook* (June 1995) and reference supplement.

primarily the unskilled and less educated, indicates a mismatch between skill requirements and skill offer. But if unemployment were mainly a skill mismatch problem, large shortages of skilled workers should appear together with surpluses of unskilled workers. Instead unemployment amongst the most qualified workers has also increased substantially.[2] Moreover, if the interaction of shifts in relative labour demand and a rigid wage scale were the main cause for European unemployment, then the structure of unemployment should vary with the degree of wage rigidity. Unemployment should be highly concentrated on the low-skilled workers where the wage scale was rigid but more equally distributed among different categories of workers where wage dispersion has widened. Again, this is not supported by the facts. The educational and occupational structure of unemployment is very similar among countries; even where the wages of the low-skilled have sharply declined, the proportion of low-skilled in total unemployment is very high.[3] This is the case in the United Kingdom and in the United States.

Thus it is more likely that large displacement effects (i.e. workers replacing others in given jobs) have played a major role. In a situation of high unemployment firms will obviously hire the most qualified workers they find on the market, even if they do not really need their skills. And workers facing a slack labour market will accept jobs for which they are over-qualified. Therefore, it is not surprising that unemployment affects massively, and to the same extent in all countries no matter the rigidity of the wage scale, the low-skilled and less-educated workers.

This has important policy implications: while there is no doubt that the low-skilled workers are the most affected by unemployment, only in a context of expansion of the total number of jobs available will training and education policies be effective. A stronger job creation is required to reduce displacement effects and help reintegrate the low-skilled into the mainstream of work.

Another widespread explanation is that the rise in the NAIRU has been caused by increasing labour market rigidities and over-generous welfare benefits. One part of the argument is that there has been a rise in voluntary unemployment as a consequence of generous levels of unemployment (or other) benefits on which the unemployed can live comfortably. Workers choose to remain unemployed rather than accept a job at a wage below their reservation wage.

However, public opinion surveys show that both the hardship of being unemployed and the value placed on having a job are so high that the unemployed would probably accept a job at a wage regardless of the level of unemployment benefits they receive, if only they were offered one. This clearly demonstrates the involuntary character of a large part of unemployment.

An analysis of the British Household Panel Study for 1991,[4] found that unemployed people have much lower levels of mental well-being than those in work. Regression analysis shows that the effect of being jobless is statistically significant and, given the same personal characteristics such as education, age, marital status, health and region, is negatively correlated with well-being. As a rough illustration, being unemployed is worse, in terms of lost "utility units" than divorce or marital separation. The key conclusion drawn from this analysis is that the unemployed are clearly suffering from their status and do not choose to be unemployed.

Moreover, the hardship associated with unemployment does not seem to have declined over time. Data from the Eurobarometer Survey[5] for a large set of countries between 1973 and 1992 indicate that the gap in life satisfaction between the employed and

Table 3.1. Employees' commitment to work in the United Kingdom, 1984-93

	1984	1985	1986	1989	1993
	%	%	%	%	%
Still prefer paid job	69	72	72	74	74
Wouldn't bother	29	27	26	25	24

Source: B. Hedges, "Work in a changing climate", in *British social attitudes*, the 11th report (Social and Community Planning Research, 1994), p. 41.

the unemployed has remained roughly constant over this period and lend no support to the notion that it has steadily become more attractive to be unemployed.

Further, while the material rewards of work obviously matter, having a job entails many other dimensions such as a social status and network, a defined social role, or the satisfaction of creative instincts. This is clearly illustrated by the findings of a British social attitude survey; when asked: "If, without having to work, you had what you would regard as a reasonable income, do you think you would still prefer to have a paid job or wouldn't you bother?", three people out of four said they would still prefer a paid job (table 3.1). Over the 1984-93 period this proportion has even slightly increased. The hypothesis that the decision to accept a job depends only on the ratio of reservation wages to wages that are offered is therefore very questionable.

Labour-market regulations have also been blamed for the rise in the NAIRU by promoting wage settlements that are higher than market clearing levels. For instance, employment security legislation and strong legal rights for trade unions are believed to strengthen the bargaining power of employed "insiders" (who are already in a strong position because they possess firm-specific skills) at the expense of unemployed "outsiders". Insiders are then able to influence the trade-off between real wages and employment in their own favour. Similarly, generous unemployment and other benefits weaken work discipline since they reduce the fear of unemployment and thus create a stronger need for employers to pay higher efficiency wages. The key point is that the persistence of wages above their market clearing level, and the related persistence of unemployment, are explained by the cumulative impact of labour market regulations: as long as the latter are not removed, high levels of unemployment will further strengthen insider power and thus feed unemployment. Within this framework the only way to reduce the NAIRU is to deregulate labour markets, weaken the power of trade unions and lower welfare benefits.

But these arguments have a major weakness : the almost steadily rising unemployment since the mid-1970s has to be explained by *increasing* rigidities on the labour market since the mid-1970s. Yet wage and employment flexibility have increased in the 1980s. Regulations on wage setting have changed as wages have become indexed to the forthcoming inflation target instead of to the past recorded inflation. Wage bargaining systems have been simplified, and the number of wage bargaining levels reduced in order to avoid the accumulation of wage increases fixed at different stages of the process (at the national, branch and enterprises levels). Regulations on dismissal procedures and severance pay have also been eased in most countries. Finally, the level and duration of unemployment benefits have progressively been reduced. As a result, wage flexibility improved during the 1980s; in fact, by the end of the 1980s wage shares (the share of wages in the value added) had returned to their pre-oil-shock levels. Estimations of wage equations also show that

real wage rigidities have not increased and are not at present higher in Europe than in the United States.[6]

The major alternative to the labour-market rigidity explanation is that the rise in both the NAIRU and the effective unemployment rates have been caused by the prolonged period of inadequate growth. Most empirical investigations of NAIRU models have emphasized three points. First, a substantial part of unemployment is still cyclical: unemployment rates are currently above the NAIRUs (see figure 3.3). This implies that demand-side policies still have a direct role to play in boosting employment creation. Second, a large part of the increase in the NAIRU is explained by the slow-down in productivity growth.[7] Since wage claims do not adjust directly to variations in labour productivity, slower productivity gains have meant that a rise in unemployment was required to keep real wages in line with productivity. This points to the crucial role that incomes policies and wage bargaining systems have to play in achieving low equilibrium unemployment rates. Third, unemployment persistence appears to reflect a slow adjustment of unemployment towards its equilibrium level rather than a rise in the equilibrium level itself.[8] With aggregate demand having been at a low level for a prolonged period, cyclical unemployment has progressively become structural as the long-term unemployed progressively lose their skills and employability, competition in the labour market is reduced and wages react more slowly to unemployment. This points to the need to implement appropriate policies to reintegrate the long-term unemployed into working life. Training and retraining for the long-term unemployed are obviously of prime importance, but complementary measures of reintegration might also be needed since, as indicated previously, unemployment has a strong negative impact on people's status, psychological well-being and self-confidence. Long unemployment spells tend to lead to apathy and to the attenuation of social interaction. So the long-term unemployed lose not only their skills and abilities but also, to some extent, their personal drive and their ability and willingness to compete for jobs.

Two other factors have also probably played a major role in the persistence of unemployment. First, by making the financing of investment more expensive, the increase in real interest rates has raised the share of profits in income that is desired by firms. This modification in the wage/profit distribution requires an increase in unemployment, and thus shifts the NAIRU upward. This points to the beneficial effects that a decrease in interest rates could have on equilibrium unemployment. A second element is related to the decline in productive capacity that has resulted from a long period of low investment. Thus, there is at present not enough capacity in the economy to respond to higher growth without inflationary tensions and/or growing balance-of-payment deficits. Any surge in demand will either directly generate a rise in the instantaneously measured NAIRU[9] or be offset by deflationary policies. In the latter case, the outcome will be the maintenance of slow growth, rising unemployment and depressed investment, which will make it even more difficult to bring unemployment down in the future. Thus a prolonged period of depressed demand can be seen as having a cumulative impact and causing unemployment to rise indefinitely. It points to the need to maintain demand at adequate levels for investment to rise, while accepting a transitory rise in inflation or the external deficit or using complementary tools to offset these temporary disequilibria.[10]

Thus the persistence of unemployment has to be explained by the interaction of inadequate growth and the rise in structural unemployment, which have combined to

maintain the economy at a low level of employment creation. This combination has had cumulative depressive impacts: slow growth generates rising unemployment, which progressively becomes structural. As a result, the rise in the NAIRU restrains the level of potential growth (i.e. the level of non-accelerating-inflation growth) and thus employment creation. In this context (i) an adverse shock can have permanent effects on the medium-term level of growth and employment, which is an argument for having strong automatic stabilizers[11] to avoid large negative shocks in the economy, and (ii) macroeconomic policies have a medium-run effect on the equilibrium level of unemployment, and will thus be effective in bringing it down. By sustaining demand during a sufficient period of time, it is likely that both cyclical as well as structural unemployment can be prevented from increasing or be reduced once they have risen.

Rising wage inequality

Since the late 1970s one of the most prominent changes in labour markets was a sharp rise in wage inequality in some industrialized countries. The increase in wage dispersion since the late 1970s followed a long postwar period during which inequality was falling with rapidly rising average living standards in advanced economies. This sudden break from the past has thus given rise to concern among the general public as well as policy-makers and has generated a considerable debate over the causes and consequences of this puzzling trend and over policies to offset the trend.

As will be seen in table 3.2 overall wage dispersion increased most dramatically in the United States, but it has also been noticeable in the 1980s in other industrialized countries such as Australia, Canada, Japan and the United Kingdom, whereas during the 1970s there was a decline or little change in overall wage dispersion. The magnitude of the increase in wage inequality in Continental Europe tended to be much smaller than it was in the United States. The United Kingdom, however, also experienced very large increases in wage dispersion, and recent data from that country and from the United States suggest that this trend continued into the early 1990s.

Most industrialized countries also experienced shifts in their relative wage structure during the 1980s. In all four countries shown in table 3.3 educational and occupational wage differentials among males and females fell in the 1970s but rose in the 1980s, except in France which experienced little change.[12] Within-group wage inequality — wage dispersion among workers with comparable education and experience — also grew substantially in the 1980s in the United States and the United Kingdom. In contrast, within-group wage inequality in France changed little over the 1980s for both males and females. It has been estimated that the rise in within-group inequality accounts for half of the rise in overall wage inequality in the United States.

There is much less consensus concerning the *causes* of this phenomenon than about the direction and magnitude of these trends. The most popular explanations offered by economists and policy-makers trace the source of rising wage inequality in industrialized countries either to growing trade with developing countries or to technological changes, which are presumed to have put downward pressure on the

Table 3.2. Trends in wage dispersion in selected industrialized countries, 1973-93

		1973	1979	1981	1985	1987	1989	1990	1993
United States									
Males	90/10	3.49	3.56				4.18		4.57
	90/50	1.82	1.79				1.99		2.12
	10/50	0.53	0.50				0.48		0.46
Females	90/10		4.00	4.02	4.45	4.77	4.89		
	90/50		1.96	2.01	2.09	2.10	2.15		
	10/50		0.49	0.50	0.47	0.44	0.44		
United Kingdom									
Males	90/10	2.50	2.42	2.66	2.92	3.05	3.21	3.21	3.47
	90/50	1.70	1.67	1.78	1.84	1.89	1.96	1.96	2.01
	10/50	0.68	0.69	0.67	0.63	0.62	0.61	0.61	0.58
Females	90/10	2.57	2.32	2.62	2.64	2.77	3.02	3.02	3.16
	90/50	1.75	1.65	1.78	1.77	1.80	1.93	1.90	1.93
	10/50	0.68	0.71	0.68	0.67	0.65	0.64	0.63	0.61
Canada[a]									
Males	90/10	3.21		3.48	4.00	3.80		3.98	
	90/50	1.67		1.67	1.68	1.71		1.75	
	10/50	0.52		0.48	0.42	0.45		0.44	
Females	90/10	3.09		3.74	4.29			3.98	
	90/50	1.70		1.76	1.76			1.75	
	10/50	0.55		0.47	0.41			0.44	
France[b]									
Males	90/10	3.23	3.31	3.25	3.30	3.38			
	90/50	2.00	2.05	2.05	2.11	2.13			
	10/50	0.62	0.62	0.63	0.64	0.63			
Females	90/10	2.65	2.60	2.66	2.58	2.73			
	90/50	1.72	1.69	1.70	1.70	1.72			
	10/50	0.65	0.65	0.64	0.66	0.63			
Germany									
Males	90/10			2.40	2.37	2.30	2.29	2.32	
	90/50			1.63	1.66	1.63	1.65	1.65	
	10/50			0.68	0.70	0.71	0.72	0.71	
Females	90/10			2.64	2.51	2.43	2.41	2.39	
	90/50			1.56	1.58	1.58	1.59	1.58	
	10/50			0.59	0.63	0.65	0.66	0.66	
Japan									
Males	90/10		2.59			2.75		2.83	
	90/50		1.63			1.67		1.73	
	10/50		0.63			0.61		0.61	
Females	90/10		2.20			2.32		2.33	
	90/50		1.54			1.65		1.63	
	10/50		0.70			0.71		0.70	
Sweden[c]									
Males	90/10	2.07		2.15	1.97	2.05		2.15	
	90/50	1.57		1.68	1.50	1.56		1.57	
	10/50	0.76		0.78	0.76	0.76		0.73	
Females	90/10	1.87		1.69	1.76	1.75		1.82	
	90/50	1.40		1.37	1.34	1.38		1.40	
	10/50	0.75		0.81	0.76	0.79		0.77	
Australia									
Males	90/10		2.00	2.08	2.14	2.15	2.23	2.23	
	90/50		1.48	1.54	1.54	1.53	1.54	1.56	
	10/50		0.74	0.74	0.72	0.71	0.69	0.70	

		1973	1979	1981	1985	1987	1989	1990	1993
Females	90/10		1.75	1.85	1.90	1.93	2.00	1.96	
	90/50		1.40	1.44	1.48	1.47	1.48	1.47	
	10/50		0.80	0.78	0.78	0.76	0.74	0.75	
Austria[d]									
Males	90/10		2.61			2.70	2.75		
	90/50		1.62			1.65	1.65		
	10/50		0.62			0.61	0.60		
Females	90/10		3.35			3.47	3.44	3.51	
	90/50		1.74			1.77	1.79	1.79	
	10/50		0.52			0.51	0.52	0.51	

[a] Data for 1986 instead of 1985, and for 1988 instead of 1987. [b] Data for 1980 instead of 1981. [c] Data for 1991 instead of 1990, and for 1988 instead of 1987. [d] Data for 1980 instead of 1979.

Notes: 90/10 refers to the wage ratio of the 90th to the 10th percentile workers. The 90/50 and 10/50 ratios are defined analogously. **United States:** Gross hourly earnings of wage and salary workers. **United Kingdom:** Gross hourly earnings of persons paid on adult rates, whose pay for the survey week was not affected by absence. **Canada:** Gross annual earnings of full-time, year-round workers. **France:** Gross annual earnings of full-time workers, adjusted for differences among individuals in annual hours worked. **Germany:** Gross monthly earnings plus benefits of full-time, full-year workers. **Japan:** Monthly scheduled earnings of regular workers at non-governmental establishments with at least 5-10 regular workers. **Sweden:** Gross hourly earnings: earnings for those not paid on an hourly basis are calculated as weekly (monthly) pay divided by corresponding reported hours worked. **Australia:** Gross weekly earnings of full-time non-managerial employees. **Austria:** Gross earnings per day, standardized to a monthly basis taking into account the recorded number of days of insurance contributions, referring to wage earners, salaried employees and some civil servants, excluding apprentices.

Source: L. Mishel and J. Bernstein: *The state of working America 1994-95* (Armonk, NY, M.E. Sharpe, 1994), table 3.17; United Kingdom Department of Employment: *New earnings survey 1993*, Part A, table 16; OECD: *Employment Outlook* (Paris, 1993), table 5.2.

wages of less-skilled workers. Others view the unequal wage development as arising mainly from changes in wage-setting institutions, government policies, or action taken by employers, rather than as a pure outcome of the interaction of market forces. One set of empirical studies on the link between trade and wage inequality has used calculations of the factor content of trade in order to derive the amount of skilled and unskilled labour that is embodied in imports and exports. The influence of trade on the relative wages of skilled and unskilled labour is then inferred by calculating the net differences in demand for the two classes of labour. Estimates based on such calculations usually show that the changing factor content of trade did shift the demand for labour against less-skilled workers and in favour of highly skilled workers.[13] However, they also show that the effect of trade on skill or educational wage differentials is relatively small; one study estimates that only 8-15 percent of the 1980-1988 increase in the college/high school wage differential is attributable to the combined effects of trade and immigration into the United States.[14]

Others who are sceptical of these estimates derived from a partial equilibrium framework have analysed the trend in commodity prices rather than the trend in volumes of trade. The results of these studies, however, seem inconclusive. One study has found that the relative United States prices of unskilled-labour-intensive commodities have risen in comparison with the prices of skilled-labour-intensive commodities. This is the opposite of the trend that would be expected if less-skilled American workers were exposed to increased competition from unskilled foreign workers.[15] On the other hand, another study finds a slight decline in the relative price of commodities that are intensive in the use of unskilled labour.[16] However, this latter study, which analysed the patterns of United States foreign trade according to a very detailed breakdown of trade by manufacturing industry and partner country, finds only a small effect of trade on manufacturing jobs. Thus, most authors conclude that although international trade has had some influence in shaping recent wage patterns, it

Table 3.3. Changes in the structure of wages in four industrialized countries

	1970s				1980s			
	United States	United Kingdom	France	Japan	United States	United Kingdom	France	Japan
Males								
Overall wage inequality[1]	+ +	—	—		+ +	+ +	+	+ +
Between-group inequality								
(a) Education/ occupation[2]	—	—	—	—	+ +	+ +	0	+
(b) Experience[3]								
College/ non-manual	+ +	0		+	–	+ +	+ +	—
High school or less/manual	0	0		+	+ +	+ +	+ +	0
Within-group inequality[4]	+ +	—	—		+ +	+ +	0	
Females								
Overall wage inequality	0	—	—		+ +	+ +	+	+ +
Between-group inequality								
(a) Education/ occupation	—	—	—		+ +	+ +	0	
Within-group inequality	+	—	—		+ +	+ +	0	

+ + = increase by a substantial magnitude
+ = small increase
0 = no change
– = small decrease
— = large decrease
blank indicates insufficient information

[1] Measured by the 90-10 log wage differential. [2] Educational and occupational (non-manual/manual) wage differentials. [3] Wage differentials by experience among college/nonmanual or high school or less/manual workers, respectively. [4] Wage differentials among workers with similar education, occupation and experience, measured by the residual of separate earnings regression for males and females with these characteristics controlled.

Source: L. Katz, G. Loveman, and D. Blanchflower: *A comparison of changes in the structure of wages in four OECD countries*, Centre for Economic Performance, Discussion paper No. 144 (London, London School of Economics and Political Science, 1993), table 3.

has not played a dominant role in pushing down the relative wage of less-skilled workers.

Other observers have also raised questions about the magnitude of the trade effect in terms of scale. For example, in 1990, 70 per cent of United States manufacturing imports came from OECD countries which have similar levels of factor endowments and wages to those of the United States. Moreover, manufacturing employment in the United States is relatively small, comprising only 23 per cent of total employment in 1979 and 18 per cent in 1989. Thus, doubts have been raised about how much trade with low-wage developing countries could have affected overall wage patterns in the United States.

The other major explanation that has been advanced is that the technology "shock" emanating from the widespread application of computers and automated technologies in recent years has been non-neutral, in the sense that it has increased the demand for high-skilled workers relative to the less-skilled. It is this relative demand shift that explains widening wage inequality. In addition, it is posited that

technological change may have increased the productivity of high-skilled workers more than that of less-skilled workers, which induced firms to bid up the relative price of skilled workers.

These claims rest on the observation that a large portion of the recent increase in wage dispersion and of the employment shift to more-educated workers has occurred within industries rather than across industries. It is argued that the fact that manufacturers are using more skilled labour despite its relatively higher price strongly supports the hypothesis that technological change in manufacturing played a significant role in the wage change.

However, because it is difficult to measure the extent of technological change and the overall effect of technology on skills, there is little direct evidence of the biased effects of technological change against unskilled workers. Instead, most analysts tend to assume that whatever portion of wage inequality that is unexplained by other observable factors is due to technological change. For example, many economists assume that the large increase in within-group wage inequality reflects increased return to *unmeasured* human capital (skills). But this is inconclusive since it is equally plausible that rising within-group wage inequality reflects institutional changes such as deunionization or decentralization of wage bargaining.

Moreover, some observers have questioned whether there was indeed a technology "shock" in the 1980s which can be distinguished from technological change in the previous decades. One United States study which analyses indicators of technological change finds no evidence of such a technology shock during the 1980s.[17] In the United States, where the rise in wage inequality has been most dramatic, the growth of investment per worker in equipment was actually slower in the 1980s than in the 1970s, although there was an acceleration of investment per worker in computerized equipment. But there is also evidence that computerized equipment did not have different effects from other types of equipment. In addition, aggregate research and development (R&D) activity grew more slowly in the 1980s, although there was a slow increase within some industries. Estimates of the impact of equipment accumulation and R&D activity on educational upgrading within industries also show that technology did not have a greater impact in the 1980s than in the 1970s. These results point to a serious weakness in the argument that "increased demand for skills" explains growing wage inequality.

There is also a problem of timing: it is pointed out that productivity growth in skill-intensive industries did not accelerate relative to other industries until the latter half of the 1980s, while wage inequality had begun to increase well before.[18]

The literature examined so far thus suggests that growing international trade and technological change can only provide partial explanations of the trend of rising wage inequality. In order to understand the phenomenon more fully, it is necessary to examine the role of changes in wage-setting institutions, employer practices or the macroeconomic environment in shaping wage patterns.

The 1980s saw a distinct trend toward deunionization, decentralization of collective bargaining, and deregulation of the labour market in virtually all industrialized countries. Some analysts have linked these changes in wage-setting institutions to the declining economic position of the less-skilled, less-educated and low-wage workers in these countries. For example, studies which analyse the effect of deunionization in the United States and in the United Kingdom find that around 20 per cent of the overall increase in wage dispersion can be accounted for by the decline in

unionization.[19] In particular, a portion of the rise in within-group wage inequality is found to be attributable to the decline in union density.

From a broader perspective, others posit that the changing macroeconomic environment since the 1970s has contributed to the trend of slow and unequal wage growth. The significance of the relationship between the macroeconomic environment and wage inequality can be seen in the contrast between the developments before and after 1973. Several relevant facts have to be mentioned. On the one hand, in the 1960s the growth of economic output and labour demand was very rapid. This allowed and gave strong incentives for firms to upgrade the skills of their workforce to meet their needs. Thus it can be assumed that the labour supply adapted to the demand more easily and without any widening in wage dispersion. On the other hand, it appears that the demand for skills in the United States did not grow particularly rapidly in the 1970s and 1980s compared to the two preceding decades.[20] On the contrary, the growth seems to have been more rapid during earlier decades, particularly during the 1950s. Thus it remains to be explained why the decrease in the relative wage of the low-skilled that emerged in the 1980s did not show up earlier. An obvious answer lies in the very different macroeconomic environment in the two periods. Just as low employment growth affected massively the less skilled in Europe because of large displacement effects (see preceding section), the low overall real-wage growth that has been recorded in the United States since the mid-1970s can be regarded as a major cause of rising wage inequalities. In a context of rising bargaining power of some groups of workers, indeed the most skilled, the outcome of competing claims over a given increase in overall wages will be much more unequal if the latter is small.[21]

This indicates that a decrease in the relative demand for unskilled workers need not necessarily generate an increase in wage dispersion or unemployment among the unskilled. Only in a context of inadequate aggregate demand for labour or low real-wage growth will such a shift generate rising wage dispersion or unemployment of the less skilled.

Labour market polarization

Institutional theorists believe that, in the United States and to some extent in the United Kingdom, the labour market is divided into separate submarkets: the "primary" labour market which is characterized by jobs offering high wages and benefits, good working conditions and training, well-defined promotional paths and high job security; and the "secondary" labour market which is characterized by jobs offering low wages and few benefits, poor working conditions, training, poor promotional changes, and frequent quits and discharges. Under this institutional context, the slower growth in demand since 1973 is believed to have led employers to create a disproportionately large number of jobs in the secondary labour market. This was manifested in the rise in wage inequality that has been discussed, as well as in the disappearance of a large number of good jobs and the rapid expansion of part-time and low-paying service-sector employment.

Several explanations have been advanced for this. One is that structural change, especially the shift from manufacturing, has been an important factor behind the growth of non-standard forms of employment. This is because the use of part-time and

temporary workers is significantly more common in services than in manufacturing, where employment mostly comprises regular jobs.

The most controversial explanation, however, is that the increase in non-standard jobs has been driven by a change in the strategies of enterprises. It has been argued that high and persistent unemployment has weakened the bargaining position of workers and made it easier for non-standard forms of employment to be introduced. At the same time, this shift has been facilitated by moves towards the deregulation of labour markets.

But an important question remains to be asked: what are the factors that have driven this increasing recourse to non-standard forms of employment? This is not an idle question since there are strong economic benefits from maintaining standard forms of employment. From the firm's viewpoint, the performance and productivity of the worker increases with experience, with repeated contact with other members of the enterprise or of the team in which the worker is inserted, with the trust and mutual understanding that develop gradually between the employer and the employee, and with the training which can be provided only if the firm can expect some long-term returns on the training expenses. From the worker's viewpoint, a job that incorporates a high probability of being extended over a long duration affords important benefits such as security and stable income. Moreover, regular jobs offer a more extensive level of fringe benefits and social security. Thus it could be argued that the optimal situation for both workers and firms is a "regular" employment relationship.

A plausible explanation of why firms have chosen to move away form this optimal situation is the increased instability of the economic environment. It has been argued that this increased instability has come about as a result of greater fluctuations in output and in relative prices, driven by accelerating structural change and increased uncertainty and competition in a globalized world economy. The creation of regular jobs entails high initial fixed cost in terms of screening and training. It also requires the taking of a long view, since the benefits from a regular employment relationship come only with the gradual build-up of experience, firm-specific knowledge and team-work. Increased instability deters such investments, since the probability of a pay-back is greatly reduced. A recourse to more flexible forms of employment now becomes a rational defensive response.

Another possible explanation is that the recourse to more flexible forms of employment is the result of the weakening of the institutional framework for promoting mutually beneficial cooperative behaviour among firms. The reason for this is that employment security generates a positive externality that can only be provided either through cooperation (for instance collective agreements) or by the State. The latter form might be the most appropriate since employment security is also typically a public good, since it would benefit all agents but no single agent has any incentive to produce it. Furthermore, an individual agent would benefit from "free rider" behaviour, giving it a competitive advantage over other firms. Hence the rationale for regulating employment security through law and collective agreement. The weakening of labour market regulation in recent times could have weakened the incentives to cooperate and thus enabled a move towards less employment security.

Towards full employment

The foregoing discussion has highlighted three labour-market developments that can be regarded as major deviations from the ideal of full employment. Large and lasting unemployment in Europe has been discussed, together with the problem of widening wage dispersion and the emergence of a large number of jobs in the "secondary" labour market. The crucial question asked was: "Is there an inevitable trade-off between the quantity and quality of employment?". To answer this question, a careful examination has been conducted of the underlying causes of these labour-market developments.

The examination of the causes of persistent high unemployment in Europe has highlighted the limitations of the explanation based on labour-market rigidities. Thus for European countries to go down the deregulation route would mean (i) relying on unclear mechanisms, as it is far from obvious that making employment and wages even more flexible will bring about a strong surge in employment creation, and (ii) imposing on those groups most affected by unemployment reductions in their incomes and conditions of work. This obviously represents a huge cost for an uncertain result. But is there an alternative route?

The answer is "yes". All three adverse labour-market developments can be seen as three different outcomes of a common phenomenon, a persistently inadequate economic environment since the mid-1970s. Because of the different institutional surroundings or characteristics of the economies (for example the fact that the United States is characterized by slow productivity growth while Europe still enjoys more dynamic productivity gains), outcomes have been different. But changing the institutions will not solve the upstream problem. It is only by solving this upstream cause that industrial economies will be able to secure full employment again.

The analysis has emphasized the role of persistent inadequate demand and its interaction with rising structural unemployment. It has shown that economic policies have a medium-term effect on growth patterns and unemployment. It should be noted that the various mechanisms mentioned for unemployment persistence are symmetric with respect to the direction of the change in aggregate demand.[22] This means that more employment-minded macroeconomic policies and stronger economic growth would reduce structural unemployment, just as restrictive macroeconomic policies and inadequate growth have increased it. It would reduce the proportion of long-term unemployed. Displacement effects (workers accepting jobs for which they are over-skilled) would disappear. It would raise the level of investment and thus the productive capacity. The pervasive effect of insiders' behaviour would also be reduced as the total number of insiders grow.[23] While it is more subject to controversy, it is also probable that higher growth would raise productivity gains and thus ease the conflict between either workers and employers or between different categories of workers over the shares of output and real earnings. In a context of buoyant growth, firms can afford and have a strong incentive to train their workers in case they need more skills, which in turn reduces "mismatch" unemployment and/or wage dispersion.

Among the causes of widening wage dispersion, the effects of trade, technology and the overall macroeconomic environment have been discussed. While it remains difficult to distinguish clearly the importance of each factor, the policies to reverse the ongoing trend towards more inequalities are clear. Education, training and retraining

of the less educated and unskilled workers are of major importance to reduce the gap between skill offers and skill requirements. In countries where the redistributive role of the State is still accepted as important, a system of transfers from workers who benefit from the development of trade or from biased technological change to workers who suffer from them is appropriate. More generally, policies aiming at reducing the cost of low-skilled labour (such as a reduction in payroll taxes or employment subsidies) are relevant for addressing the problem of the worsening position of unskilled workers.[24] And a more buoyant macroeconomic environment would also bring about stronger overall wage increases, reduce polarization and thus presumably lower wage dispersion.

The increasing segmentation of labour markets has to be largely related to defensive enterprise strategies in a context of increased macroeconomic instability. It has been emphasized that the creation of regular jobs requires simultaneously a *stable* environment in which enterprises can be confident about medium-term prospects and a *buoyant* environment, as regular jobs are not created at will but rather must correspond to some real employment prospect in the firm, which in turn depends on the existence of demand for output.

Thus, the "third route", which could achieve the ideal attributes of full employment, consists of getting back to — and then securing in the medium term — an adequate level of economic growth. This requires assuring adequate and stable levels of demand and profits[25] to initiate and prolong a new cycle of strong but non-inflationary growth. The tool for this is the simultaneous implementation of more demand-minded macroeconomic policies and proper structural policies. A prerequisite is a strong and credible reduction in real interest rates. This will bring about a reduction in the debt-servicing burden and thus facilitate the reduction of fiscal deficits. A major recourse to fiscal automatic stabilizers is also appropriate in order to prevent large adverse shocks that are likely to have a persisting impact on the medium-term growth path and unemployment levels. The reduction of public deficits and debts should still remain a major medium-term objective, but the required restrictive measures should be applied only after the economies have been placed on a sustained growth path. Only in a context of higher growth and reduced interest rates will the reduction in government debt-servicing, together with the savings on social security from reduced unemployment and the increased tax revenues, permit a substantial reduction of public debts and deficits.

The opposite sequence — reducing, first, public deficits and debts in order to generate a decrease in interest rates and a surge in investment and growth — might only lead to more unemployment. It is based on the hypothesis that (i) any reduction in public deficit generates immediately a corresponding surge in private investment, and (ii) increased investment allows for an increase in production capacities and thus in production. In reality, in the present situation neither of these two relations appears to hold : a decrease in total demand (generated by the reduction in public consumption) reduces private investment (as private investment responds primarily to demand and production expectations and is hardly crowded out by public investment), and a rise in productive capacities does not spontaneously generate a surge in production if the demand is not increased at the same time. Thus, starting with a reduction in public deficits would perhaps bring about some decrease in real interest rates if financial markets believe that this policy will succeed. But, rapidly, this policy would deter growth and employment, lead to more unemployment and by the end have only a

small impact on deficits, as the reduction in growth would immediately reduce tax revenues and increase social security spending. Thus, this policy would even lose its credibility vis-à-vis the financial markets and would ultimately have only a transitory impact on interest rates.

Thus the only way to reduce simultaneously unemployment and public deficits in the medium term is to rely on monetary relaxation to sustain activity while using budgetary automatic stabilizers to smooth cycles but keep a medium-term objective of public debt. For real interest rates to decrease subsequent to the relaxation of monetary policies, financial markets must be ensured that the medium-term objective of stabilization or reduction of the public debt will be met with higher growth, and that short-term interest rates will remain at low levels for a sufficiently long period of time. This requires strong coordination among industrialized countries, which will have to design consistent macroeconomic policies. It also means assuring financial markets that any surge in inflation will be tackled by budgetary rather than by monetary restriction which in turn requires strong coordination in each country between budgetary and monetary authorities.

Of course, a surge in growth might generate temporary disequilibria, such as inflationary tensions or external deficits due to labour or capital shortages.[29] If transitory inflation or external deficits and debts are immediately seen as unacceptable by governments and financial markets, then growth will immediately be slowed down by economic policies before there has been time for physical and human capital investments to reduce these shortages. Thus it is important to define what can be considered as "acceptable" disequilibria and what has to be seen as unacceptable. It is also important to design complementary policies to attenuate those disequilibria. Labour market policies aiming at enhancing the availability and quality of the labour force, such as training the less skilled and upgrading the skills and ability to work of the long-term unemployed, are important. A reduction in the social contributions paid by employers on wages would be beneficial for two reasons: first, it would reduce capital-labour substitution; second, it would have an anti-inflationary impact. In a context of unemployment affecting massively the unskilled and long-term unemployed, targeting the reduction in social contributions to these groups of workers appears particularly adequate. Providing incentives for firms to invest will also be crucial for the production capacities to expand: the rate of return on investments should be kept at a high level, which means that wages have to be at a level compatible with the required profit rate, and long-term interest rates have to decrease. Institutional mechanisms for regulating pay settlements will also be critical. In that regard, implementing a government-imposed income policy — such as a wage freeze, a tax-based income policy, or various forms of anti-union legislation — does not appear appropriate in the present context. Instead, what should be sought is a wide agreement between unions and employers over wage settlements, within the framework of a social consensus around the objective of full employment; this may, or may not, involve the government. Only on this condition could the return to full employment be achieved without major wage-driven inflation. More generally, all mechanisms that reinforce coordination between bargaining parties (among unions as well as among employers) are likely to promote wage moderation. This is easier to achieve under centralized systems of wage bargaining, but there are also examples of successful coordination under decentralized systems. In the latter case mechanisms such as the provision of objectives and credible forecasts of macroeconomic constraints, social

dialogue to promote agreement on keeping wage settlements within these constraints, and the synchronization of the wage bargaining process, have all proved helpful. Lastly, a strong coordination of national economic policies will also ease external-deficit problems, soften losses of competitiveness generated by inflationary tensions, and at the same time reinforce the credibility of the implemented policies.

Notes

[1] UNCTAD: *Trade and Development Report* (Geneva, 1995). This will particularly be the case in countries where unemployment benefits, or more generally social protection, are low or non-existent, since the worker will have no choice but to find some way of living.

[2] See *The OECD job study: Evidence and explanations*, table 1.16, p. 41. It can be seen from the data in this table that in countries where unemployment has risen during the 1980s this rise has also affected the most educated workers. Depending on countries and gender, the unemployment rate among the 25 per cent most educated workers has risen by one to five points.

[3] A. Atkinson et al.: *Pour l'emploi et la cohésion sociale*, Ch. 5 (Presses de la Fondation Nationale des Sciences Politiques, Références/OFCE, 1994). See also *The OECD job study*, op. cit., table 1.16, which shows that in the late 1980s/early 1990s, the unemployment rate among the 25 per cent less educated male workers reached 11 per cent in Germany, 9 per cent in France (two countries where hardly any widening in wage dispersion had been recorded over the last two decades), 11.6 per cent in the United Kingdom, 8 per cent in the United States (where the dispersion of wages had widely increased especially in the 1980s). This means that the unemployment rate of the male less educated workers was approximately 2.7 times the unemployment rate of the most educated male workers in France and Germany, while this ratio reached 3.5 in the United States and 5.2 in the United Kingdom.

[4] A. E. Clark and A. J. Oswald: "Unhappiness and unemployment", in *Economic Journal*, May 1994, pp. 648-659.

[5] The main question analysed was: "On the whole are you very satisfied, fairly satisfied, not very satisfied, or not at all satisfied with the life you lead?", in A. J. Oswald: "Happiness and economic performance" (mimeographed), forthcoming.

[6] E. Confais, P. A. Muet: "Les rigidités du marché du travail", in P. A. Muet (ed.): *Le chômage persistant en Europe* (Paris, Presses de la Fondation Nationale des Sciences Politiques, Références/OFCE, 1994); S. Rauffet, P. Richardson and D. Turner: "The role of real and nominal rigidities in macroeconomic adjustment: A comparative study of the G3 economies", in *OECD Economic Studies* (Paris), No. 21, Winter 1993.

[7] Confais, op. cit.

[8] J. Elmeskov and M. MacFarlan: "Unemployment persistence", in *OECD Economic Studies*, op. cit.

[9] As, at a given rate of unemployment, prices increase in response to the growing tensions on productive capacities. But this is different from an increase in the NAIRU that would reflect a *slower response of wages* to unemployment, as it could be captured in a wage equation. An important point is that an economy can simultaneously operate at full productive capacity and high unemployment. This has led some authors, for example Elmeskov (1994), to consider a rising unemployment associated with a given level of capacity utilization as one indicator of the increase in structural unemployment. It should nevertheless be noticed that "structural" has a particular meaning in that context, in that it does not directly reflect any wage rigidity but rather measures the proportion of unemployment that will not be reduced unless the productive capacity of the economy is increased.

[10] See the analysis developed in ILO: *World employment 1995* (Geneva, 1995).

[11] In a recession, tax revenue declines and social security expenditure rises with unemployment, and thus the budget deficit is increased without any structural change in receipts or expenditures. This has a smoothing effect on the economic cycle, sustaining aggregate demand. Similarly, during an economic upswing a reduction of the budget deficit has a negative impact on growth. Thus the public budget has a strong counter-cyclical effect.

[12] Among the countries for which data are available, the only exception to this pattern is found in the Netherlands, where less educated workers actually gained on higher educated workers between 1983 and 1987. See P. Gottschalk and M. Joyce: *The impact of technological change, deindustrialization, and*

internationalization of trade on earnings inequality – An international perspective, Luxembourg Income Study Working Paper 85, 1993.

[13] K. M. Murphy and F. Welch: "The role of international trade in wage differentials", in M. Kosters (ed.): *Workers and their wages* (Washington, DC, AEI Press, 1991), pp. 39-69; G. J. Borjas, R. B. Freeman and L. F. Katz: "On the labor market effects of immigration and trade", in G. J. Borjas and R. B. Freeman (eds.): *Immigration and the work force* (Chicago, University of Chicago Press, 1992), pp. 213-244; and A. Wood: North-South trade, employment and inequality: *Changing fortunes in a skill-driven world* (Oxford, Oxford University Press, 1994).

[14] Borjas, Freeman and Katz, loc. cit.

[15] R. Lawrence and M. Slaughter: "International trade and American wages in the 1980s: Giant sucking sound or small hiccup?", in *Brookings Papers on Economic Activity: Microeconomics*, 1993, No. 3, pp. 161-226.

[16] J. D. Sachs and H. J. Shatz: "Trade and jobs in U.S. manufacturing", in *Brookings Papers on Economic Activity*, 1994, No. 1, pp. 1-84.

[17] L. Mishel and J. Bernstein: *The state of working America 1994-95* (Washington, DC, Economic Policy Institute, 1994), Ch. 3.

[18] UNCTAD: *Trade and development report, 1995* (New York and Geneva, 1995), pp. 156-158.

[19] R. B. Freeman: "How much has de-unionization contributed to the rise in male earnings inequality?", in S. Danziger and P. Gottschalk (eds.): *Uneven tides: Rising inequality in America* (New York, Russel Sage Foundation, 1993), pp. 133-163; A. Gosling and S. Machin: *Trade unions and the dispersion of earnings in British establishments, 1980-90*, NBER Working Paper No. 4732, 1994.

[20] K. M. Murphy and F. Welch: "Occupational change and the demand for skill, 1940-1990", in *The American Economic Review*, May 1993.

[21] While it can be assumed that each category of worker will be equally happy with a similar 3 per cent real wage increase, if the total to share amounts to 0.5 or 1 per cent the most powerful categories will obtain the whole increase or even more at the expense of the less powerful ones.

[22] W. Carlin and D. Soskice: *Macroeconomics and the wage bargain: A modern approach to employment inflation and the wage rate* (Oxford, Oxford University Press, 1990).

[23] Indeed, it would be very irrational for firms facing dynamic demand not to increase their work force because unions bargain for higher wages instead of higher employment.

[24] P. Minford, J. Riley and E. Nowell: *The elixir of growth: Trade, non-traded goods and development* (London, Centre for Economic Policy Research, Discussion Paper No. 1165); J. Drèze and E. Malinvaud: *Growth and employment: The scope of a European initiative*, in European Economy Reports and Studies No. 38, 1994, pp. 489-504; H. Sterdyniack, E. Fournam, F. Lerais, H. Delessy, F. Busson: "Lutter contre le chômage de masse en Europe", in *Revue de l'OFCE* (Paris), Jan. 1994.

[25] To prevent both Keynesian (due to insufficient demand for output) and classical (due to inadequate profitability of firms) unemployment.

[26] As, notwithstanding the high level of unemployment, labour shortages are likely to appear among particular categories of workers, mainly the most skilled, or as the re-absorption of long-term unemployed into the workforce takes time.

CHAPTER IV

TRANSITION ECONOMIES

INTRODUCTION

Prior to the inception of the process of transition to a market economy in 1990, the then centrally-planned economies had been characterized by a socialist version of full employment. Not only was there no open unemployment; there were also exceptionally high rates of labour force participation in comparison to market economies. This was true for both men and women and extended to older workers as well. There was in fact a guaranteed right to employment that often became akin to a requirement to work, because the extensive mobilization of labour was central to the socialist strategy of growth.

Judged against the standards of the definition of full employment in a market economy, there were two weaknesses in the socialist version of full employment. First, there were reasons to doubt whether all the employment was in fact freely chosen. This applied to both the basic decision over whether or not to work and to the choice of particular jobs. The doubt arose because labour allocation was done through administrative means under central planning. Secondly, much of the employment was not productive since there was extensive labour hoarding within enterprises. Labour productivity and wages were typically low.

This socialist full employment ended abruptly with the collapse of communism. There was a rapid emergence of mass unemployment from the beginning of the transition process, and some five years later the problem remains very grave. Indeed, in spite of encouraging signs of a revival in growth rates in several European transition economies since 1994, there are grounds for continuing concern over the prospects for an imminent improvement in the employment situation. A fundamental reason for this concern is that, given the legacy of labour hoarding in state enterprises from the socialist era, a revival of growth may not by itself be sufficient to reduce unemployment for some time to come. Growth in the transition economies has to be based on increasing their international competitiveness and raising the productivity of labour. This has to be achieved through a continuation of market reforms and the restructuring of uncompetitive enterprises. But this in turn will imply continued labour shedding. Thus, unless employment opportunities in new private enterprises grow more rapidly than this labour shedding, there is unlikely to be a swift reduction in unemployment. A major issue that will be addressed in this chapter is therefore whether there are feasible policies for reducing unemployment, or at least for containing its rise, while these economies press on with the transition process.

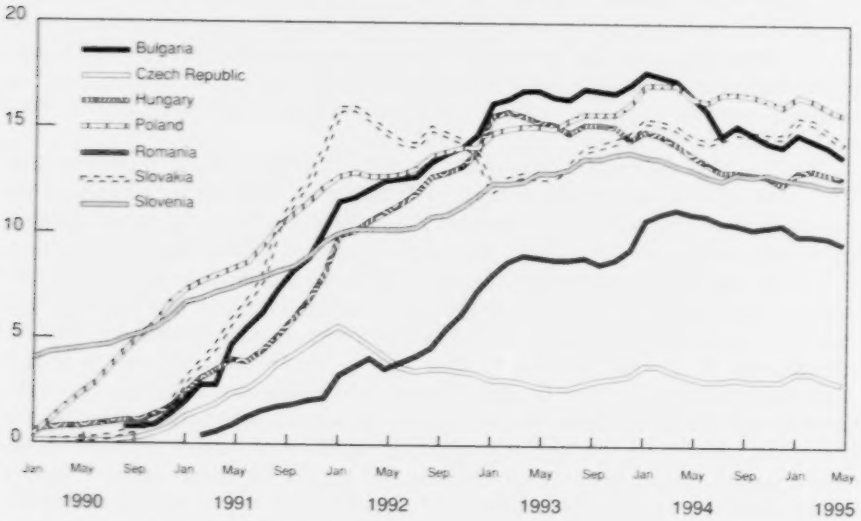
This is a formidable challenge but one that must be faced. In embarking on the transition to a market economy the former centrally-planned economies did not abandon the objective of full employment. This is reflected in the fact that most of the transition economies have endorsed the obligations under Convention No. 122 and

have reaffirmed in their new legislation the principle of the right to work or to employment. There is also clear concern over the widespread social ill effects of high unemployment and the threat this poses to the social and political sustainability of the transition process. But the objective of full employment will now have to be interpreted in the same way as it is in industrialized market economies, marking a sharp break from the former socialist version of it.

THE EMERGENCE OF MASS UNEMPLOYMENT

One of the most dramatic developments since the start of the transition process has been the sharp and rapid rise in unemployment. As shown in figure 4.1, in Bulgaria, Hungary, Poland, and Slovakia unemployment rates shot up from zero to above 15 per cent of the labour force within two years of the initiation of the transition process. This rapid appearance of unemployment was the most dramatic in Slovakia, where the unemployment rate climbed from 2 to 15.9 per cent in just one year. The other three countries reached a comparable unemployment level one year later.

Figure 4.1. Unemployment rates in transition economies (per cent)



Source: OECD-CCET: Labour market database 1995.

The growth in unemployment in the Czech Republic, Romania and Slovenia was less drastic in comparison. The Czech Republic is the only transition country that has been able to contain open unemployment at a very low level. It is seen from figure 4.1 that the unemployment rate grew moderately in the first year of reforms, then fell quickly and stabilized between 3-4 per cent since mid-1992. Slovenia was the only country in the region that started the reforms with open unemployment. The number of the unemployed increased steadily until late 1993, when it started to decrease slightly. The changes in the unemployment rates in Romania followed a similar pattern,

Table 4.1. Unemployment

	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia	Slovenia
	1995 Q1[1]	1995 Q1	1995 Q1	1995 Q1	1994 Q1	1995 Q1	1994 Q2[2]
Sex							
Males (% male labour force (LF))	18.6	3.7	12.5	13.6	7.7	14.3	8.5
Female (% female LF)	19.8	4.8	8.8	16.1	8.7	14.5	9.6
Education							
Higher (% LF with higher education)	6.7	1.2	2.9	4.2	3.1	3.4	
Secondary (% LF with higher education)	17.1	3.4	10.2	16.2	10.0	13.1	
Primary (% LF with secondary education)	30.4	10.7	16.7	16.4	7.0	30.0	
Age							
Youth							
Male (% male LF)	42.6	8.2	26.0	31.7	20.2	29.2	21.2
Female (% female LF)	41.8	8.7	15.8	35.9	25.7	24.8	23.1
Prime-age							
Male (% male LF)	16.0	2.8	10.8	12.2	6.4	11.4	8.4
Female (% female LF)	16.9	4.5	7.8	15.2	7.9	12.8	6.5
Older							
Male (% male LF)	13.1	1.9	7.2	8.8	2.7	9.3	4.9
Female (% female LF)	13.5	2.5	4.7	7.7	2.7	8.9	6.5
Duration							
<1 month (% total unemployment)	2.3	14.8	6.9	6.2	2.7	5.0	4.9
1-6 months (% total unemployment)	19.4	38.1	24.7	28.1	38.5	26.0	19.5
7-12 months (% total unemployment)	15.8	20.0	22.8	24.0	13.5	16.3	17.1
>12 months (% total unemployment)	62.2	27.1	45.7	41.7	45.3	52.8	58.5
Long-term unemployment							
Male (% male unemployment)	61.7	26.2	46.0	38.2	39.6	49.8	60.4
Female (% female unemployment)	62.8	28.0	46.0	45.1	51.0	53.4	51.4
Youth (% youth unemployment)	51.7	18.5	32.3	29.0		40.0	42.3
Older (% older unemployment)	31.1	28.6	42.2	44.8	48.8	62.7	57.1
Discouraged workers							
Male (% male unemployment	27.2[3]	5.6	26.9	8.8[4]	63.8	2.4[4]	
Female (% female unemployment)	22.8[3]	5.8	19.2	9.1[4]	37.4	3.0[4]	

Note: Unless otherwise indicated, figures are for the second quarter for Slovenia, and for the first quarter for all other countries.
[1] First quarter. [2] Second quarter. [3] 1993, third quarter. [4] 1994, fourth quarter.
Sources: OECD-CCET: Labour market database, 1995; OECD: *Short-term Economic Indicators: Transition Economies*, No. 3, 1995.

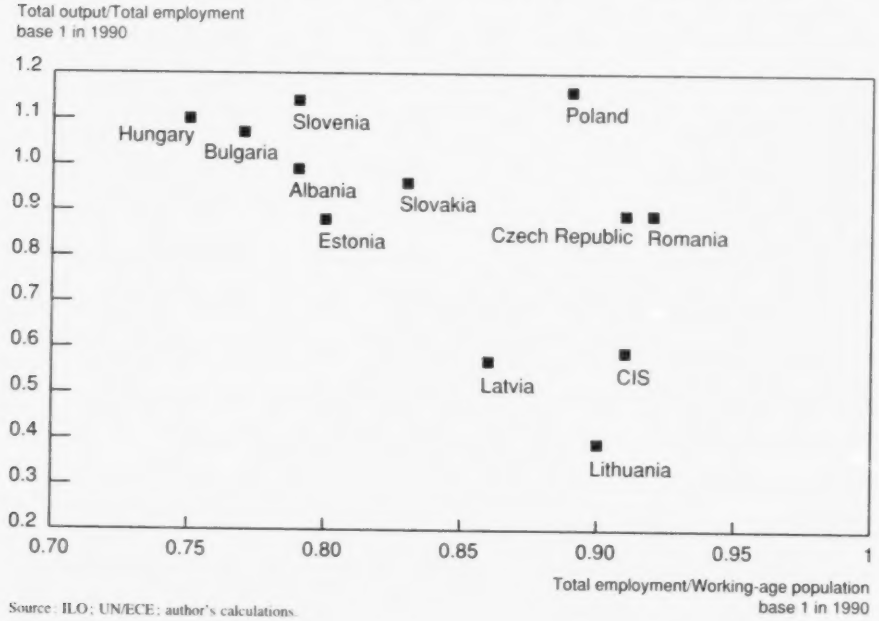
although the unemployment growth started at virtually zero. But in spite of recent slight decreases unemployment remains above 12 per cent in Slovenia and almost 10 per cent in Romania.

A particularly disturbing aspect of the unemployment problem has been the rise in long-term unemployment in all transition economies (table 4.1). With the exception of the Czech Republic, the number who have been unemployed for more than 12 months has increased continuously. In Bulgaria, Slovakia and Slovenia a majority of all the unemployed are long-term. Moreover, women face a bigger long-term unemployment threat than men in all countries. Older workers too are particularly vulnerable to long-term unemployment.

Notwithstanding this strong increase in unemployment rates, the most prominent feature in the present period is probably the persistence of extensive labour hoarding. Due to the logic of guaranteed full employment, the former production structures were extremely labour intensive. Thus the normalization that will be required, at least in sectors that are exposed to international competition, implies very large gains in production per head. This requires either a large drop in employment, or a considerable expansion of production, or both.

So far, employment losses have remained modest in relation to the decline in production. From the productivity viewpoint, the reduction in labour hoarding has been modest. This is illustrated by figure 4.2. Since 1990, all countries under review have been moving towards lower employment rates but only few of them have recorded substantial productivity increases. Poland appears to be in the best position, with significant output and productivity increases and a relatively small decline in the employment rate.

Figure 4.2. Labour productivity and employment rate in transition economies, 1990-94



Source: ILO; UN/ECE; author's calculations.

This shows that structural reforms have not yet had a definitive impact on the labour market. Hence the present slight decrease in unemployment, which is related to the ongoing recovery, does not seem sustainable in the medium run if transition economies are to converge towards Western standards of productivity, unless they rapidly and durably get back on a rapid growth path. Unemployment rates can be expected to remain at high levels, all the more since the room for manoeuvre in terms of the reduction in the active population has not occurred as yet.

Another area for concern is that unemployment is a particularly serious problem for women in the transition economies. This is reflected not only by the higher levels of unemployment in the female labour force as compared to men but also by the fact that even though women make up a minority of the national labour force, they are the majority among the unemployed in most countries.

Other groups that have been disproportionately hit by unemployment are the low skilled and youth. Those with only a primary education have been the hardest hit by the economic transformation, while the unemployment rates among those with higher education are below a third of the national average in all countries.

Youth unemployment rates are particularly high in all countries for which data are available. While on average they make up less than 15 per cent of the labour force, more than 30 per cent of the unemployed are below the age of 25. The youth unemployment rates are twice as high as the national average.

Apart from the rise in unemployment the collapse of output and high inflation have brought about a sharp decrease in real wages in all countries in the past five years (table 4.2). In Eastern Europe, the biggest one-year decline in real wages occurred in 1990 for Poland and Slovenia, and 1991 for the rest. The trend has reversed itself in a number of countries, such as the Czech Republic and Hungary, since 1992, while in others, such as Bulgaria, high inflation still dwarfs the growth of nominal wages. In the CIS countries the decline in real wages continues. Moreover, despite several efforts to adjust minimum wages upwards to keep them in line with the rising prices, they are still at a level of no more than 40 per cent of the average wages, and far below social subsistence levels.

These employment and wage trends thus reveal that five years into the transition process the shortfall from full employment remains enormous. A basic cause of these adverse changes in the employment situation was the sharp fall in output experienced by these countries between 1990 and 1993 (table 4.3). This fall in output was greater than had been expected due, to a significant extent, to a combination of adverse developments in the external economic environment during these years. The collapse of intra-CMEA trade in the wake of the collapse of the socialist system imparted a major external shock to these countries. This coincided with the onset of recession in several Western European countries. This limited the extent to which exports could be switched to these markets after the collapse of intra-CMEA trade. The recession was also partly responsible for the lower than anticipated inflows of foreign direct investment into the transition economies. In addition, the rise in real interest rates in international financial markets intensified the debt servicing burdens of a number of countries that had been heavily indebted before the transition process began.

These adverse external developments affected all transition economies alike, irrespective of the intensity of the reforms that were adopted. This has made it difficult to establish a clear relationship between the intensity of reforms and outcomes in terms of output and employment. It is, nevertheless, possible to discern some

Table 4.2. Annual changes in real wages

	1989	1990	1991	1992	1993	1994	1995
Albania		0.37	– 42.63	– 30.9	– 33.8		
Bulgaria		6.2	– 42.3	14.9	1.3	– 20.5	
Czech Republic	0.9	– 5.7	– 26.1	13.6	0.1	7.7	4.5
Hungary	2.2	– 8.3	– 3.1	2.5	2.8	2.45	– 7.5
Poland	10.4	– 28.8	– 5.4	– 6.3	2.8	– 1.2	– 0.2
Romania	3.3	6.1	– 19.4	– 13.3	– 14.9	1.15	
Slovakia	0.9	– 5.7	– 26.1	7.5	– 7.2	4.5	
Slovenia	27.59	– 26.51	– 23.17	– 1.19	11.23	5.96	
Belarus	7.23	11.13	4.5	– 11.3	– 30.0		
Kazakstan			– 10.7	10.8	– 11.6	– 31.3	
Kyrgyzstan			40.5	– 30.3	– 51.5	– 25.8	
Russia		– 44.2	– 36.5	– 58.7	4	– 8	
Ukraine			31	– 41	– 58		
Uzbekistan			– 18.3	2.8	6.3	– 42.1	
Minimum wage to average wage ratios							
Albania		66	40	31	49		
Bulgaria		43.7	53.3	35.9	38.3	36.8	34.7
Czech Republic			52.3	47.1	37.4	31.9	27.5
Hungary	34.6	37.3	37.4	35.9	32.8	31.2	
Poland	18	21	34	43	41	43	43
Romania	66.4	57.2	55.5	42.3	39.2	31.4	26.2
Slovakia			52.3	48.5	41	38.9	37.1
Russia	27	24	14	9	9	7	10
Ukraine		32.3	53	20.3	7.6	3	0.8
Minimum wage to subsistence minimum ratios							
Albania			35	23	40		
Bulgaria				73.6	77.4	60.1	50.1
Czech Republic				200			90.1
Hungary	97.3	93.8	93.7	98	79.7	78	
Poland	51	47	63	71	64	66	
Romania	67.9	46	42	35.9			
Slovakia				200	200	198	198
Russia				24	26	17	18
Ukraine		72.7	62.5	30.7	5.1	3	1.2

Sources: ILO: *Bulletin of Labour Statistics, 1994*; IMF: *International Financial Statistics*, various issues; OECD: *Short-term Economic Indicators*, No. 3, 1995; D. Vaughan-Whitehead: Minimum wages in Central and Eastern Europe: Slippage of the anchor, Ch. II of G. Standing and D. Vaughan-Whitehead (eds.): *Minimum wages in East and Central Europe; From protection to destination* (Geneva, ILO, Central and Eastern European Team and Central European University Press, Budapest, 1995).

differences, especially in the response to the improved external economic environment in 1994 and 1995.

In general, the recovery in output has been strongest in those countries which reformed earliest and which have made the most progress in reform. Particularly striking is the contrast between the continuing falls in output in the countries of the

Table 4.3. General economic indicators

	Real GDP % growth				Inflation rate %				General government balance % GDP				Exchange rate % growth	CMEA share % growth	Exports % growth	Imports % growth
	1989	1990-93 average	1994	1995 estimate	1989	1990-93 average	1994	1995 estimate	1989	1990-93 average	1994	1995 estimate	1990-94 average	1990-93 average	1989-93 average	1989-93 average
Albania	9.8	– 10.1	7.4	6.0	0.0	69.2	22.6	7.0	– 5.5	– 11.5	– 14.0	– 13.0	63.9		– 22.1	10.2
Bulgaria	0.5	– 7.7	1.4	2.5	6.4	103.8	96.3	68.0	– 1.4	– 14.6	– 7.0		97.7	– 23	– 14.1	– 12.4
Czech Republic	1.4	– 5.6	2.6	4.0	2.3	23.6	10.0	10.0	– 2.8	– 1.0	1.0	0.0	13.8	– 41	– 1.1	– 0.4
Hungary	0.7	– 4.9	2.0	3.0	17.0	27.2	18.8	29.0	– 1.4	– 3.4	– 8.2		12.2	– 44	– 2.1	9.7
Poland	0.2	– 3.4	5.0	5.5	251.1	118.0	132.2	27.0	– 7.4	– 3.3	– 2.5	– 3.1	73.4	– 63	– 0.7	9.9
Romania	– 5.8	– 7.0	3.4	4.0	1.1	137.7	131.0	40.0	8.4	– 0.7	– 3.0	– 2.0	154.2	– 8	– 11.4	3.6
Slovakia	1.4	– 6.6	4.8	5.0	2.3	24.7	13.4	11.0	– 2.8	– 5.4	– 3.7	– 3.0	16.2	– 41	– 3.7	4.3
Slovenia	– 1.8	– 4.3	5.5	6.0	1 306.0	174.1	19.8	15.0	0.3	0.8	– 1.0	– 0.6	113.6		10.7	15.9
Estonia	– 1.1	– 10.0	6.0	6.0	6.1	203.9	48.0	25.0	2.8	1.7	0.9	1.0	3.7[1]	– 44		
Latvia	6.8	– 15.0	2.0	1.0	4.7	171.7	35.7	25.0	1.0	2.3	– 1.7	– 1.6	– 19.4[1]	– 30		
Lithuania	1.5	– 21.0	1.7	5.0	2.1	276.4	72.0	35.0	– 3.8	0.9	– 1.5	– 1.0	118.7[2]	– 27		
Belarus	8.0	– 6.5	– 21.5	– 10.0	1.7	303.4	2 220.0	700.0		– 2.1	– 1.5			2		
Russia		– 11.3	– 15.0	– 3.0	2.0	314.3	302.0	205.0		– 19.1	– 9.9	– 5.7	416.8	– 18	– 12.2	– 23.4
Ukraine	4.0	– 12.4	– 23.0	– 5.0	2.2	495.9	891.0	350.0		– 17.5	– 9.1	– 4.0	903.9	– 11		
Kazakstan	– 0.4	– 9.8	– 25.0	– 12.0		377.3	1 880.0	180.0	0.0	– 3.8	– 6.5	– 5.0	678.4	– 6		
Kyrgyzstan	4.0	– 10.8	– 27.0	– 5.0		292.9	280.0	45.0	2.1	– 6.5	– 8.4	– 12.0	416.2	– 9		
Uzbekistan	3.7	– 3.2	– 2.6	– 4.0	0.7	206.9	746.0	325.0	– 0.9	– 9.2	– 2.0	– 4.0	– 17	– 17		

[1] 1993-94. [2] 1991-94.

Source: EBRD: *Transition Report 1995*; ECE: *Economic Survey of Europe*; World Bank: *Foreign trade in transition: The international environment and domestic policy*.

former Soviet Union (which started reforms later and which have made the least progress) and in the other transition economies in Central and Eastern Europe. This could be taken as an indication that the early reformers are now better placed to benefit from the improved external economic environment, especially because of the progress they have made in trade and price liberalization and currency reforms.

The transition process

In spite of the emergence of mass unemployment and the large falls in output in the initial years, considerable progress has none the less been made in the transition process, although the degree of achievement has been uneven across countries.[1] Budget deficits have been reduced in a number of countries by means of cuts in subsidies, current outlays, and capital expenditure, and also through the introduction of a modern tax system to raise revenue. However, even though some fundamental tax reforms have been undertaken in a number of the countries, the overall process has been largely ad hoc and incomplete. As a result of the slow pace of fiscal reform, most countries in the region were still plagued by unbalanced state budgets as late as 1994, and estimates for 1995 show nearly no improvement.

As part of the initial stabilization programme a restrictive monetary policy was stressed, and there has been substantial achievement with regard to interest rate liberalization throughout the region. Banks are now free to set their own rates, and the market-determined interest rates were mostly positive in real terms by 1994. The exceptions are the CIS countries, where state administrative controls over interest rates are still common and the nominal rates often lag behind inflation.

High inflation has been one of the most striking initial features of the economic transition. With the exception of the Czech Republic, Hungary and Slovakia, all countries in the region have experienced at some point inflation rates of three digits or higher between 1990-94. The situation was particularly severe in the former Soviet Union. By 1994, however, most governments in Eastern Europe and the Baltic had managed to reduce inflation rates. In contrast, in the CIS countries inflation rates were still between 280 and 2,220 per cent in 1994.

In terms of currency convertibility most countries in the area have conformed to the norm that prevailed in Western Europe between 1950-80, which calls for full current account convertibility but some restrictions on the capital account. The Baltic States have moved faster and committed themselves to virtually free convertibility on both accounts, whereas the CIS countries lag behind with many still having in place heavy controls over all areas of foreign transactions.

One of the most striking features of economies in transition is the speed at which they have liberalized their foreign trade sectors. Especially when one judges according to their import regimes, many countries in the region have come to be among the most open economies in the world, having almost no tariffs and limited variances of duties across products. Direct controls through quotas and licensing on imports have generally been abolished. The only significant exceptions are some of the more advanced reformers — the Czech Republic, Hungary, Slovakia and Slovenia. On the export side, more controls are still in place. With the exception of Poland and the Baltic States export restrictions in the form of taxes, quotas, or licences remain in place in all countries.

With the exception of Belarus all countries of the region have re-oriented the destination of their exports to some extent since reforms began. This is best reflected in the share of inter-state trade among Eastern bloc countries. The early reformers, including the Czech Republic, Estonia, Hungary, Poland and Slovakia, experienced a bigger decline in CMEA trade than others. Another notable change in the sphere of international trade was the general decline of total trade volumes, especially that of exports. The exception is Slovenia. As shown in table 4.3, it is the only country that has enjoyed healthy growth between 1989-93 in terms of both imports and exports.

One key element in a well-functioning market economy is a robust private business sector. Five years into intensive economic reforms, many countries in Eastern Europe and the former Soviet Union, notably the Visegrad four (Czech Republic, Hungary, Poland, Slovakia), the Baltic states and Russia, have established a private sector that contributes to more than half of the national GDP and employs a substantial percentage of the labour force. The growth of private enterprises outside the state sector has been spontaneous, with the development of an encouraging environment and the deepening of price and trade liberalization.

The privatization of small-scale state-owned enterprises (SOEs) has also gone a long way in most of Eastern Europe, the Baltic States, as well as Russia and Kyrgyzstan. An exception is Bulgaria, which despite a relatively early start has continued to make only slow progress in this area. The privatization of large-scale SOEs, however, has turned out to be much more difficult than expected. Only the Czech Republic, Russia and Slovakia have made any significant achievement in transferring existing state assets into private hands, by means of mass voucher privatization. Such a process has been gradual but steady in Hungary ; by the end of 1994 a substantial share of the large-scale companies were either fully privately owned or had less than 50 per cent state ownership. Among the rest of the transition economies, Estonia, Lithuania and Poland have also made noticeable progress, each having privatized 30 per cent of the SOEs.

However, privatization is but a means to a goal. The real issue remains that of establishing effective governance of the enterprises undergoing restructuring. For those countries that have gone through early mass privatization, the bulk of restructuring was left to the new owners, who in turn relied on market pressures to establish effective governance mechanisms. Apart from the Czech Republic, Russia and Slovakia, where privatization is nearly complete, Lithuania and Romania also appear determined to follow a similar route. An alternative approach has been for the government to initiate the financial restructuring of those enterprises and banks in financial difficulties before launching privatization. Estonia, Hungary, Poland and Slovenia have adopted this approach.

Nevertheless, the progress of restructuring has been slow regardless of the chosen approach. While there are indications that some restructuring has taken place in response to privatization, a cut in state subsidies or a tightening of bank credits, rarely has the rationalization in the enterprise sector reflected systematically implemented government restructuring programmes. The enforcement of bankruptcy laws is weak. Only Hungary has gone very far in this respect.

The above discussion of the relative accomplishments of the transition economies in major areas of economic reform reveals that some countries have clearly moved ahead of others on all fronts of the reform process. The Visegrad four are consistently

more advanced in their transition to market economies. Slovenia, albeit slow in establishing a robust private sector, has made comparable progress in all other areas. The Baltic States, especially Estonia, are also well advanced in the process; in particular, they are among the countries with the most liberal international trade regimes in the world. The CIS countries, on the other hand, have generally been plagued with various setbacks; a number of these countries have failed to carry out even rudimentary reforms.

It is important to note, however, that even in the most advanced reforming countries there is still a large remaining agenda of reform. This is particularly true with respect to the restructuring of enterprises and the development of institutions appropriate to a market economy, such as clear property rights, a modern tax system and credible bankruptcy laws. The instruments for macroeconomic management and selective intervention to guide the reform process also need to be strengthened. It has, for instance, been argued that up till now there has been a vacuum in macroeconomic management that has been detrimental to economic performance. Macroeconomic policies in most countries have been confined to passive stabilization measures, without any attempt to use counter-cyclical measures when this was warranted. There were understandable reasons for this in the initial years of the reform process when there was very little room for manoeuvre. In this period there was the need to fend off the danger of hyperinflation in very difficult circumstances. These included the monetary overhang carried over from the previous system, the price liberalization and devaluation that had to be introduced, and the unfavourable external economic environment. However, when circumstances changed later on, a pro-cyclical stance still continued to be maintained when more expansionary policies would have been appropriate. In this latter period the problem of the monetary overhang had been eliminated by high inflation, high unemployment had removed the danger of a wage-price spiral, public expenditure had been reduced drastically, and the effective demand for domestic output had fallen sharply. There was thus scope for recourse to a more counter-cyclical macroeconomic policy stance that was not exploited.

Regardless of whether or not one agrees with these observations about the appropriateness of the macroeconomic policies that have been adopted so far, there should be agreement on one fundamental point. This is the fact that the transition economies have to develop the same capacity for macroeconomic management that exists in industrialized market economies. This obvious point bears reiteration because it has often been overlooked in the transition economies in the wake of their new-found enthusiasm for free markets and a minimalist state. Even in market economies macroeconomic management is important for ensuring stable growth and achieving employment and other social objectives. Similarly, public investment in improving infrastructure and the quality of the labour force has a vital role to play in promoting increased international competitiveness and growth in market economies.

The optimal speed of transition: Opposing views

As we have seen from the earlier review of progress to date in the transition process, countries have proceeded at different speeds. A key issue in the policy debate on the transition has been the relative merits of a "big bang" versus a more gradual implementation of reforms. The standard big-bang or shock-therapy prescription consists of proceeding as fast as possible with macroeconomic stabilization,

liberalization of domestic trade and prices, current account convertibility, privatization and the creation of a social safety net, while simultaneously creating the legal framework for a market economy.[2]

Proponents of the "big-bang" approach stress the interdependence of various components of the transition process and argue that a more gradual, piecemeal approach would not be feasible. For instance, it is argued that stopping inflation requires simultaneous action in expenditure reduction, reform of the tax system, enterprise reform, and allowing genuine market prices to emerge. Similarly, it is argued that microeconomic structural reforms cannot take place without macroeconomic stability.

This position has been questioned on several grounds. It has been pointed out that it has proved possible to implement substantial structural change, including trade liberalization, in high-inflation environments in Eastern Europe.[3] It has also been argued that attempted simultaneity has caused significant sequencing problems: price, trade and financial liberalization has in many cases exacerbated either the internal or the external balance, thus calling for further stabilization.[4]

With respect to privatization, the "big-bang" approach has been to implement this at a stroke. But critics have pointed out that in pursuing this approach governments have fallen into the trap of "state desertion" of state-owned enterprises, with no policy towards them except to undermine them by cutting off finance. This has led to an excessive loss of output and employment. A preferred strategy, supported by recent research, would be to privatize more gradually while providing incentives for potentially competitive SOEs to adapt.[5]

In the labour market the hard line is that a sharp rise in unemployment is an essential part of the transition: it helps the growth of the private sector, holds down wages, strengthens the hand of employers in enforcing discipline and work effort, reinforces the credibility of a reform programme by demonstrating that bankruptcies can happen, etc. But even those in favour of shock therapy in general have pointed to the danger of unfettered market forces leading to an unemployment rate that is too high. At an early stage, for instance, some analysts warned that: in the absence of well-functioning financial markets, too many firms may go bankrupt, including the merely illiquid as well as the insolvent; firms may fire too many workers if wages are above market-clearing rates; and, once it arrives, high unemployment may become "normal" and difficult to reduce.[6] More recently, it has been pointed out that, contrary to the arguments of shock therapists that unemployment is necessary to release labour for new private sector activities, most private firms in Central and Eastern Europe recruit directly from state enterprises rather than from the pool of unemployed. It has also been pointed out that very high unemployment rates are associated with waste, distress and extreme hardship; the growth of long-term unemployment has particularly corrosive social effects and reduces the extent to which unemployment contains wage pressures; and high unemployment increases the risk of a political backlash against a reform programme as a whole.[7]

With respect to trade liberalization, it has been argued that it is not necessary to phase out import tariffs altogether and instantaneously.[8] There is a case for recourse to selective trade liberalization and selective export credits and subsidies. This could be supported by replacing policies of generalized support for state enterprises with those of selective support for potentially viable enterprises in areas of acute economic distress.

It is difficult to resolve this debate on alternative transition strategies on the basis of the experience to date of the transition economies. A major complicating element in the debate is that it has been difficult in practice to classify countries as having unambiguously followed one strategy or the other. The reason for this is that countries have for the most part proceeded at different paces in each of the different major dimensions of reform. For instance, Hungary, praised by some and criticized by others, is often classified as gradualist, yet its policies on trade reform, stabilization, privatization and the foreign sector are no different from those in countries hailed as bold reformers. Moreover, wage employment in Hungary has fallen more, in relation to the fall in its GDP, than in most of its neighbours. Similarly, the Czech Republic is counted among the shock therapists by some yet, viewed from the labour market, the Czech example is one of relatively painless transition, with low unemployment rates.

Another major difficulty is that the outcomes associated with different strategies have themselves been the subject of dispute, as have been the extent to which they are attributable to differences in policy rather than to other things. The gradualists maintain that the results of shock therapy in Eastern Europe and the Soviet Union have been disastrous, and that the elimination of queuing and the availability of Western goods cannot be taken as a sign of rising living standards.[9] A recent study documents a sharp rise in poverty and deterioration in welfare in Eastern Europe over the 1989-93 period, using not only income- and consumption-based indicators but also those related to demography, mortality, health, social cohesion and protection, and education. These changes are attributed, at least partly, to the choice of an accelerated approach to transition. In China, on the other hand, the study claims that, although avoidable social costs have been incurred and serious policy problems such as a growing regional imbalance remain, there has been a "phenomenal" reduction in poverty incidence over the past 12 years. This is attributed to the gradualist approach followed, which is regarded as far more efficient and equitable.[10]

There have been two lines of defence against these charges. One has been to deny that welfare has fallen in Central and Eastern Europe. Thus it has been argued that the living standards of the population have not really dropped, "if one examines actual consumption behaviour (rather than changes in crude indexes of real wages, which do not give a picture of the shortages prevalent in the old regime). Indeed, in many countries ... the public is in the midst of a startling build-up of consumer durables — cars, refrigerators, videocassette recorders, and the like — that were long unavailable under the old regime".[11]

A second line of defence has been to deny that all the good things that happened in China and the bad things in Eastern Europe were attributable to choice of transition strategy. Thus at least part of China's relative success is due to: its unusually high household savings rate; peculiarities of its economic structure and initial conditions (widespread rural underemployment, a relatively small SOE sector and absence of a macroeconomic crisis); and the special role of the overseas Chinese.[12] As for Eastern Europe, any negative effects have been due to the largely exogenous fall in aggregate demand (due partly to the collapse of the CMEA trading system and of the Soviet Union) rather than to the strategy chosen for restructuring and stabilization.[13]

Is there an alternative strategy for dealing with unemployment?

Regardless of how this debate is finally resolved, it is clear that the transition from central planning to labour markets has turned out, in most countries, to be much more painful than was expected. Most European transitional economies have responded to this by importing the Western European benefit-plus-programmes approach to unemployment. This involves revealing rather than hiding unemployment, and dealing with it through a combination of passive and active labour market programmes — unemployment benefit (for a limited period) and assistance with job search for the registered unemployed, plus training, credit and other programmes to improve chances of success in the labour market. This approach is, however, likely to imply having to live with high open unemployment for some more years to come. As mentioned earlier, even if the recent revival in growth is sustained, labour demand is unlikely to increase immediately because further reforms, especially enterprise restructuring to raise labour productivity and competitiveness, will entail more jobs losses.

If there is an alternative to this prospect of continuing pain in the labour market, it is surely worth exploring. There are two obvious examples of an alternative approach. One, China, is different in so many dimensions from most transitional economies that the lessons of its experience must be heavily qualified. The other, the Czech Republic, may be more instructive. Some of the elements of an alternative strategy are in fact implicit in the experience of China and the Czech Republic. It would involve the retention of surplus labour in state enterprises, rather than forcing them to lay off workers or to go bankrupt; and the devising of non-market ways of adding to the demand for labour.

One possible alternative is to offer selective subsidies to state enterprises on unemployment-avoidance grounds (as opposed to generalized subsidies on political-expediency grounds). But the conditions for such subsidies would need to be precise and explicit. It has been suggested that criteria for such support should include: positive value added by the enterprise in question; a fiscal cost that is sustainable (on the basis of a comparison of value added per worker, wage and unemployment benefit avoided); and evidence that the enterprise's insolvency is only transitional.[14] Support would then be confined to cases where the local unemployment rate is very much above the national average, exogenous constraints limit labour mobility, high unemployment causes major tensions, and support for enterprises is transitional and transparent. However, it is important to avoid creating perverse incentives. This might involve filing for bankruptcy and handing the enterprise over to the official receiver as a condition of support.

Whether it makes sense to continue to subsidize a state enterprise rather than to force it to lay off workers will depend, for instance, on a comparison of wage and value added per worker, on the one hand, with unemployment benefit, on the other. A useful numerical example of a calculation of the relative costs of offering selective subsidies to state enterprises on unemployment-avoidance grounds has been given as follows: "to think in terms of illustrative numbers, one might have value added per worker in an enterprise of $40, a wage of, say, $70, and unemployment benefits of $50. Supporting the enterprise is then both cheaper to the government (costing $30 per worker as against $50 per worker for benefits) and economically more efficient in that the value added in the enterprise is positive".[15]

Table 4.4. Comparison of average wage and GDP per employee in manufacturing industry with average unemployment

	Year	Sector	Units per months	Average wage	GDP per employee	Average unemployment benefit	6 + 5 - 4	(6 + 5)/4
Bulgaria	1992	Industry	Leva	2 225	7 092	780	5 647	3.5
Czech Republic	1993	Industry	Korun	5 845	21 174	1 653	16 982	3.9
Hungary	1993	Manufacturing	Forint	26 491	59 714	9 947	43 170	2.6
Poland	1993	Industry	'000 Zloty	4 198	15 546	1 602	12 950	4.1
Romania	1993	Manufacturing	'000 Lei	72	228	21	177	3.5
Slovakia	1992	Industry	Korun	4 431	19 060	2 135	16 764	4.8

Sources: OECD-CCET: Labour market database; European Commission: *Employment Observatory: Central and Eastern Europe*, May 1995.

There are grounds for believing that these relative cost conditions are met in some countries, hence providing a basis for using selective subsidies. Table 4.4 shows the national averages for wage and GDP per employee in industry/manufacturing and unemployment benefit in six Central and Eastern European economies in 1992/93. In all cases, the sum of GDP per employee and average unemployment benefit (approximating the cost of closure) exceeds the average wage (approximating the cost of subsidy) — most so in the case of Slovakia, least so in the case of Hungary. Of course, these are averages for all enterprises in these sectors, including the profitable ones: the relevant figures are those for the marginal state enterprises, which would be lower. But this bias is offset to some extent by the fact that the average unemployment benefit (per person receiving benefit) understates the cost of unemployment: an increasing proportion of the unemployed receive no benefit, but of these many now receive social assistance, and the cost of administering all programmes to deal with the unemployed has to be added to the cost of the benefit or assistance received. In any case, if the wage and benefit figures in the table were accepted as realistic cost elements, they would, for instance, imply that marginal state enterprises in Bulgaria would be worth supporting by a wage subsidy if each worker could generate value added equivalent to only 65 per cent of his/her wage; the comparable figures for the other countries would be 72 per cent (Czech Republic), 62 per cent (Hungary), 62 per cent (Poland), 71 per cent (Romania) and 52 per cent (Slovakia).

Such support would not be unconditional. The conditions already quoted would confine it to cases where the local unemployment rate is very much above average, labour mobility is limited, and high unemployment causes major tensions.[16] The second condition applies to all Eastern European economies, where housing markets are in their infancy. The first and third focus particular attention on the Montana region in Bulgaria, north-eastern Hungary, the northern and north-eastern regions of Poland, northern Moldova in Romania, and eastern Slovakia.

Another element of an alternative strategy would be a greater reliance on public works programmes to generate employment. Such programmes have been curiously neglected in most European transitional economies, partly because they are traditionally associated with low-skilled work for uneducated workers. Slovenia is one of the few countries to have succeeded in changing the image of public works,

involving unemployed persons with secondary schooling and higher education, as well as the less schooled, in programmes (non-competitive with local private business) in social services, public administration, education, culture, tourism, ecology, agriculture and forestry and communal infrastructure. Wages must not exceed 70 per cent of the market rate for the particular job.[17] This looks like the ideal model of public works for an alternative strategy.

The criterion for choosing between public works and passive unemployment assistance is relatively simple, at least in principle. The average benefit per participant that is generated by the programme should exceed the average cost per participant minus the average cost of unemployment benefit.

The benefits of public works include: income arising from the assets created by public works; the additional income arising (through linkages to supplying industries and the multiplier) from the difference between the costs of the scheme (wages to participants and cost of inputs, etc.) and unemployment benefits; the costs of future long-term unemployment avoided by maintenance of attachment to the labour market; and the value of the reduction in the psychological stress of unemployment. Hungarian data suggest that this criterion may often favour public works programmes over passive programmes: an estimate of the monthly cost per head for such programmes was 10,963 forints in 1993, which is lower than unemployment benefit alone for those unemployed for less than a year and only slightly higher than the figure for the longer-term unemployed.[18]

A necessary condition for the viability of such an alternative strategy is a wage and incentives policy which ensures that: (i) state enterprises in receipt of subsidies do not pay more to their marginal employees than those employees could expect to receive in the non-state sector; (ii) unemployment benefits are below market wages for all categories; (iii) public works programmes pay a wage rate for each type of worker below what that worker could obtain in a normal job but above what he/she would be paid as unemployment benefit/assistance.

Finally, another element of an alternative strategy could be the adoption (at least temporarily) of a more relaxed policy towards productive and socially useful forms of self-employment in the unregistered economy. The benefits would consist of the extra income and employment generated as well as corresponding saving in unemployment benefits. The costs would consist of the taxes foregone and may include disorderly appearance, traffic congestion, negative impact on the registered economy in the same sector and on tourism, and crime. This would be offset to some extent by the reduction in the costs of policing (some would say, harassing) the sector. Consideration of these net costs will define the extent of relaxation that can be tolerated. For instance, vigilance against crime could be maintained without threatening the other benefits accruing from a more relaxed policy stance.

The importance of wages in the strategy implies a key role for tripartite bargaining structures. A recent study analysing the anatomy of tripartite failure in Hungary usefully identifies four conditions for success in this endeavour: (1) a strong government, with popular support and enough resources to "buy" the cooperation of its social partners — the labour unions and employers' associations; (2) strong and internally united social partners, with the legitimacy and capacity to bring pressure to bear on each other and the government and to accept negotiated compromises, and the ability to sell those compromises to their members; (3) similar views, shared by all three partners, on the proper way of intervening in a market economy; and (4) an

Table 4.5. Government expenditure on subsidies, tax arrears of enterprises, and government expenditure on unemployment compensation and employment programmes, as a percentage of GDP, selected East and Central European countries, 1993

	Non-housing budgetary subsidies[1]	Enterprise tax arrears[1]	Unemployment compensation[2]	Spending on employment programmes[2]
Czech Republic	3.6	4.0	0.2	0.2
Slovakia	4.8	5.4	0.8	0.9
Hungary	2.3	6.9	2.5	0.6
Poland	2.0	4.6	1.7	0.3

Sources: [1] M. E. Schaffer, 1995: *Government subsidies to enterprises in Central and Eastern Europe: Budgetary subsidies and tax arrears*, CEPR Discussion Paper No. 1144 (London, CEPR, Mar. 1995). [2] Papers submitted to the Conference on Employment Policies and Programmes in Central and Eastern Europe, Ministry of Labour and ILO/Japan Project on Employment Policies for Transition, Budapest, June 1994.

appropriate institutional and legal framework for negotiation and settlement between the parties.[19]

Countries will vary in the extent to which all four of these conditions hold. Some governments are in an apparently good position to embark on dialogue with labour and employers, but their hands are tied in many cases by fiscal crisis and the need to stabilize the economy. They come to the table with nothing to offer in return for the sacrifices requested from partners. There is no magic way out of this dilemma, but the alternative labour market strategy that has been outlined does offer the chance of a bargain, without necessarily stepping outside the stabilization context. Government can offer a policy of job-protection, through selective, temporary support to state enterprises on unemployment-avoidance or dynamic-comparative-advantage grounds, selective protection against imports, export promotion and public works schemes, etc., and in return will ask for selective wage restraint (in subsidized state enterprises) from unions, and a responsible attitude towards workers on the part of employers.

Given the large budget deficits currently faced by many transition economies, any strategy which adds to a government's budget deficit is unlikely to be given serious consideration. What are the possibilities of achieving the strategy's labour-market objectives through redistribution of government expenditure rather than through additional spending? Table 4.5 compares government expenditure on subsidies, enterprises' tax arrears, and government expenditure on unemployment compensation and employment programmes in four countries.

The relatively small proportion of GDP devoted to budgetary subsidies (compared with 16 to 25 per cent in 1986) is striking. In two cases, Hungary and Poland, it is smaller than the proportion allocated to unemployment compensation and employment programmes. Tax arrears are a much more important form of subsidy. Thus switching of expenditure from unemployment compensation and employment programmes (and from other expenditures associated with unemployment such as social assistance) to enterprise subsidies could have a substantial proportionate impact on them, which would be enhanced for individual firms by selectivity. Moreover, if selection criteria were strictly followed, such a switch would lead to a higher GDP than otherwise, to the benefit of tax receipts. Similarly, if the emphasis of remaining employment programmes were switched to asset-creating public works, this would also have a favourable impact on incomes and tax receipts. Although detailed

investigation is needed, it looks at least possible that the funds available would be adequate for the short-to-medium-term, unemployment-avoidance part of an alternative strategy.

Notes

[1] EBRD: *Transition Report: Economic transition in Eastern Europe and the former Soviet Union* (London, Oct. 1994); *Transition Report Update (1995)*; *Transition Report 1995: Investment and enterprise development*.

[2] P. Murrell: "The transition according to Cambridge, Mass.", in *The Journal of Economic Literature*, Mar. 1995, pp. 164-178.

[3] R. Portes: "Policy bumps on the road from Marx to market", in *Transition*, Oct. 1994.

[4] G. A. Cornia: *Income distribution, poverty and welfare in transitional economies: A comparison between Eastern Europe and China*, Innocenti Occasional Papers, Economic Policy Series, No. 44 (Florence, UNICEF International Child Development Centre, Oct. 1994), p. 20.

[5] Portes, op. cit., p. 14.

[6] O. Blanchard et al.: *Reform in Eastern Europe* (Cambridge, Mass., and London, MIT Press, 1991), pp. 81-85.

[7] R. Jackman, M. Rutkowski: "Labour markets: Wages and employment", in N. Barr (ed.): *Labour markets and social policy in Central and Eastern Europe: The transition and beyond* (New York, Oxford University Press, 1994), p. 147.

[8] Blanchard et al., op. cit., p. 87.

[9] P. Nolan: *Transforming Stalinist systems: China's reforms in the light of Russian and Eastern European experience*, Discussion Papers on Economic Transition, No. DPET 9203 (University of Cambridge, Department of Applied Economics, 1992), p. 14.

[10] Cornia, op. cit., pp. 41-44.

[11] J. Sachs: "Postcommunist parties and the politics of entitlements", in *Transition* (Washington, DC, World Bank), Mar. 1995, p. 1.

[12] T. W. Wing: "The art of reforming centrally planned economies: Comparing China, Poland and Russia", in *Journal of Comparative Economics*, June 1994, pp. 297-305.

[13] Wing, op. cit., p. 291; World Bank: *World Development Report 1995: Workers in an integrating world* (Washington, DC, 1995).

[14] Jackman and Rutkowski, op. cit., p. 148.

[15] ibid., p. 149.

[16] ibid.

[17] S. Drobnic: *Employment policy and labour market programmes in Slovenia*, Paper for the Conference on Employment Policies and Programmes in Central and Eastern Europe, Ministry of Labour and ILO/Japan Project on Employment Policies for Transition, Budapest, June 1994.

[18] M. Frey: *The role of the State in employment policy and labour market programmes: The Hungarian case in international comparison*, Paper for the Conference on Employment Policies and Programmes in Central and Eastern Europe, Ministry of Labour and ILO/Japan Project on Employment Policies for Transition, Budapest, June 1994.

[19] L. Héthy: "The anatomy of tripartite failure: Attempted social and economic agreement in Hungary", in *International Labour Review*, No. 3, 1995, pp. 361-376.

CHAPTER V

DEVELOPING COUNTRIES

Introduction

Full employment should be a priority objective of economic policy in developing countries. While it is true that the concept was originally developed in relation to the significantly different employment conditions of industrialized countries, this does not restrict its usefulness only to these countries. The concept can, and should, be adapted to serve as the organizing framework for employment policies in developing countries.

Unlike industrialized countries, regular wage employment is not the dominant mode of employment in developing countries. Instead the majority of the employed are in some form of self-employment (peasant farming, petty production in the informal sector) or in casual wage employment. Such employment is usually seasonal or intermittent. Engagement in multiple activities is fairly common but in spite of this there is often considerable underutilization of labour and the returns to work are often insufficient to stave off poverty. Regular waged or salaried employment is available to only a minority of the employed who are in the organized or modern sector. In low-income countries such employment accounts for only 5 to 10 per cent of total employment, although this proportion increases steadily with the level of development.

Given these characteristics of employment it is obvious that the question of what constitutes full employment in developing countries is more complicated than in industrialized countries. It cannot be defined only with reference to a given rate of open unemployment, since this is a very limited indicator of changes in employment conditions and in overall welfare. The reason is that there is typically little open unemployment in developing countries and unemployment rates do not vary much in the face of changing economic conditions. This is because of the predominance of self- and casual employment and the absence of unemployment benefits. For the self-employed and the casually employed economic adversity is absorbed through a fall in income and increased underemployment and not open unemployment. Moreover, in the absence of unemployment benefits very few workers, even among those in regular wage employment, can afford to remain unemployed. Hence the response to the loss of a regular job is to have recourse to whatever inferior employment is available (or can be improvised) in the informal sector. The potential unemployment in this case has been disguised by the acceptance of a lower-productivity job. In all these cases employment conditions deteriorate without its being reflected in a rise in the unemployment rate.

In view of this, the relevant indicators of changes in employment conditions should be the changes in the degree of underemployment (the number of days of work that is available and the earnings from such work) and in the extent of disguised

unemployment. But this only provides criteria for judging whether the employment situation is improving or deteriorating; it does not tell us what full employment is or why it would be a useful policy objective.

In most developing countries the current employment situation falls far short of any reasonable definition of full employment. There are major shortfalls in terms of both the quantity and the quality of employment. There is insufficient work for all who seek it, as shown by the prevalence of endemic underemployment. Many workers in self- or casual employment, especially in rural areas, would choose to work more if more work were available throughout the year. But there is even a more serious shortfall in terms of the quality of employment, since much of the work that is available in the rural and informal sectors is characterized by low productivity and penurious earnings. Moreover the conditions of employment are often physically onerous, exploitative, and insecure. Sometimes the problem of substandard employment extends even to the modern sector, as evidenced by the controversies over working conditions in export-processing zones. There are also pockets of grossly unacceptable forms of employment such as bonded and child labour which have to be eliminated.

Given the magnitude of these shortfalls it is clear that for most developing countries full employment can only be attained in the long term through sustained economic development. But this does not detract from its usefulness as an overarching policy objective. There are three basic reasons for this. First, it focuses very clearly on the two key dimensions of the employment problem that need to be tackled in tandem, that is, to accelerate the rate of job creation in the modern sector while also increasing employment opportunities, productivity and incomes in rural and informal sector activities. Secondly, the focus on these two dimensions of the employment problem constitutes a powerful strategy for achieving equitable growth. Expanding productive employment opportunities for the poor is the most effective means of reducing poverty and income inequality. Thirdly, the objective of full employment usefully incorporates the need to improve employment conditions and eliminate violations of basic labour standards as an integral part of overall employment policy.

It might of course be objected that, defined in such a broad way, the objective of full employment becomes too daunting and hence of limited use as a guide to practical policies and programmes. The time horizon is too long and the injunction to simultaneous action on several fronts detracts from the unavoidable need to make hard choices between competing priorities. Could this not be a case where the best would be the enemy of the good? In other words, increasing employment opportunities even of poor quality is already a tall order and should perhaps not be complicated by concern over the need to improve employment conditions.

The response to this apparently reasonable concern is twofold. First, it is based on the erroneous perception that there is necessarily a trade-off between the quality and the quantity of employment. On the contrary, there are policies which can achieve both objectives simultaneously. For example, agricultural development programmes, such as the provision of better irrigation, infrastructure, credit and extension services to small farmers, will raise the quantity of employment as well as the productivity and incomes associated with that employment. The same is true of small- and medium-enterprise development programmes which can simultaneously raise both job creation and incomes. The moral is that policies which successfully promote growth are likely to raise both the quantity and quality of employment. Secondly, it is wrong to think

that there is an inevitable either/or choice between promoting employment growth in the modern sector on the one hand and in the rural and informal sectors on the other. Balanced growth between sectors can be a mutually reinforcing process and is often an optimal strategy for equitable development.

As regards the objection that the full employment objective is of limited use because it is too long-term in character, two obvious rebuttals come to mind. First, development itself is an equally long-term and even broader objective yet it is widely accepted. Secondly, being a long-term objective does not mean that it cannot be translated into a series of interim shorter-term objectives against which progress can be measured. As indicated earlier, it is feasible to measure progress towards full employment through a combination of indicators on changes in employment conditions. Concretely, it can be said that there is unambiguous progress towards full employment where, for example, the rate of growth of modern-sector employment is greater than the rate of growth of the labour force and where at the same time the extent of underemployment in the rural and informal sectors is diminishing.

Employment trends

Statistics on employment and unemployment in developing countries are scarce and often do not allow for clear judgements to be made on whether overall employment conditions are improving or deteriorating. As will be seen from table 5.1, the number of countries for which there are time-series data on employment growth is fairly limited. But even for these countries it is difficult to judge what proportion of the job creation has been in the modern sector or what has been happening to the extent of underemployment and to productivity and incomes in employment outside the formal sector.

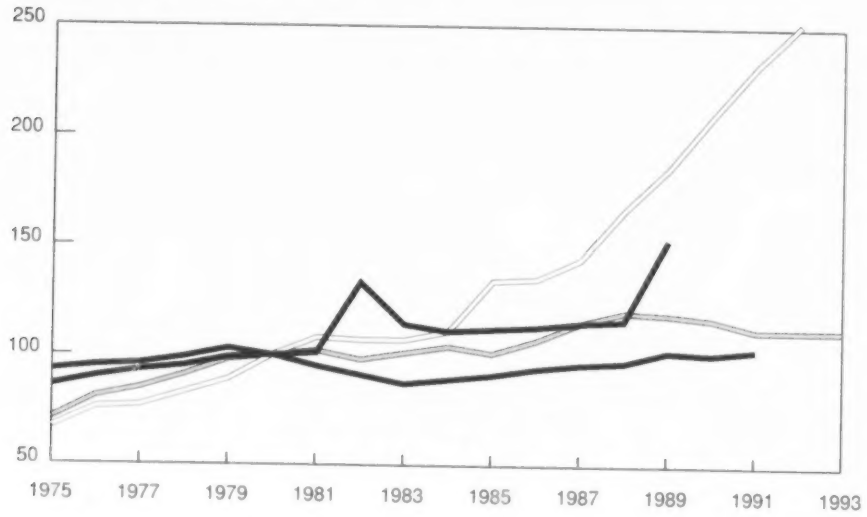
The figures for Latin America and the Caribbean show that employment growth declined sharply during the years of the debt crisis (1981-85) but has since recovered, although for the most part these are still below the growth rates in the pre-crisis period. In half of the countries for which the relevant data are available employment growth between 1986 and 1992 has been below the rate of growth of the labour force. Unemployment rates are over 14 per cent in 7 of the 11 countries for which data are available. Three other indicators point to the generally unsatisfactory employment performance. First, as shown in figure 5.1, manufacturing employment was stagnant until 1991. Secondly, real wages in manufacturing declined for most of the period. Thirdly, scattered information available for some countries suggests that the share of employment in low-productivity employment has increased.[1]

The picture is on the whole better in Asia. In the rapidly growing economies of East and South-East Asia there has been sustained and high employment growth. Between 1986 and 1992, with the sole exception of Indonesia, employment grew at more than 3 per cent per annum, well in excess of the rate of increase in the labour force. Moreover, the high rate of increase in manufacturing employment and of real wages in that sector (figure 5.1), indicates that there has been a rapid shift of labour into modern-sector employment. However, in the slower-growing economies such as India, Pakistan, Myanmar and the Philippines employment performance has been weaker.

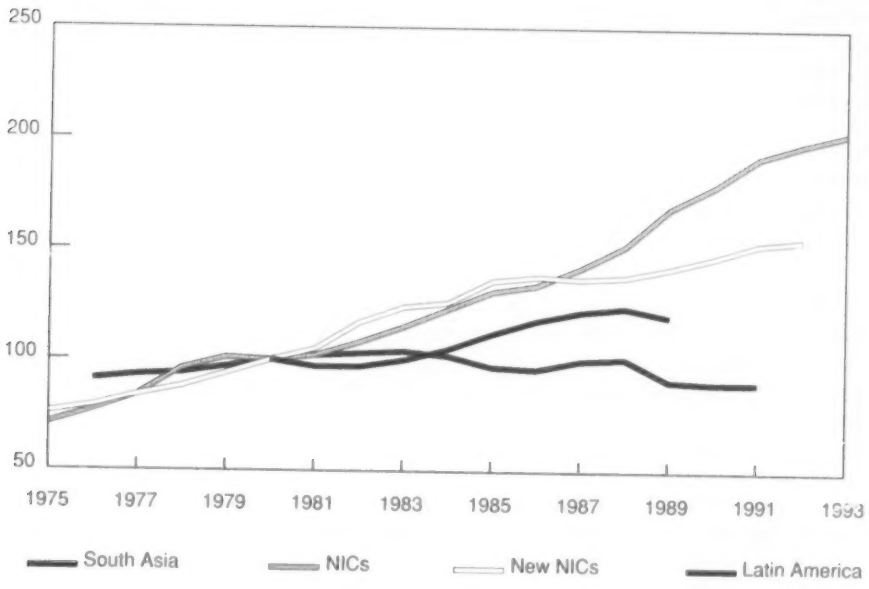
There is hardly any direct information on total employment growth in sub-Saharan Africa. The figure for African countries in table 5.1 comes from

Figure 5.1. Manufacturing employment and real earnings (index base 1980 = 100)

Manufacturing employment



Manufacturing real earnings



Latin America: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Jamaica, Mexico, Panama, Uruguay, Venezuela. **South Asia:** Bangladesh, India, Pakistan, Sri Lanka. **NICs** (newly industrialized countries and areas): Hong Kong, Republic of Korea, Singapore. **New NICs:** Indonesia, Malaysia.

Source: World Bank: world tables 1995.

Table 5.1 (a). Employment, Latin America (percentages)

	Growth of labour force (average annual growth)			Total employment growth (average annual growth)			Total unemployment rate			
	1975-80	1981-85	1986-93	1975-80	1981-85	1986-92	1975-80	1981-85	1986-93	1994
Bolivia	2.13	2.70	2.71	2.68	– 0.38	1.97	5.48	13.50	19.50	
Brazil	3.37	2.33	2.12	3.94	4.30	2.93				
Chile	2.54	2.58	1.98	3.74	0.95	3.33	12.92	14.30	6.01	
Colombia	2.51	2.84	2.42	8.70	0.66	4.01				
Costa Rica	4.03	3.07	2.47	4.01	2.74	3.62	5.22	7.78	4.93	
Jamaica	3.32	2.96	2.50	0.92	2.30	2.16	24.30	26.10	18.23	
Mexico	4.41	3.23	3.13							
Argentina	0.82	1.10	1.31							
Ecuador	2.69	3.08	2.95							
Guyana	4.00	3.05	2.54							
Honduras	3.47	3.84	3.90							
Panama	2.53	2.96	2.74	3.42	3.79	2.35	7.74	10.13	14.10	
Uruguay	0.50	0.64	0.84							
Dominican Republic	3.22	3.46	3.14							
El Salvador	3.02	2.92	3.29	– 2.79	0.40	– 0.15				
Guatemala	2.08	2.82	3.16							
Haiti	0.94	1.98	2.15							
Nicaragua	2.70	3.78	3.94					3.20	8.33	
Paraguay	3.50	3.13	2.86			3.67				
Peru	3.39	2.91	2.83							
Trinidad and Tobago	1.75	2.57	2.09	1.56	0.25	0.44	12.28	12.04	20.18	
Venezuela	4.83	3.48	3.09	3.91	1.81	4.10	5.53	9.92	8.81	8.9
Barbados	1.92	1.46	1.48	0.34	– 2.08	0.52	13.54	15.06	18.29	
Bermuda				2.43	1.66	0.52				
Cuba	3.20	2.25	2.07							
Puerto Rico	1.71	1.73	2.26	2.45	0.48	3.30	18.28	21.74	16.13	
Suriname	1.55	2.35	2.82			– 1.24			16.43	

Source: ILO: *Yearbook of Labour Statistics*; World Bank: world tables 1995; ECLAC: *Panorama Economico de America Latina, 1995*.

establishment surveys which cover only part of total employment (the coverage ranges from 8 to 60 per cent of the labour force). They indicate that in 5 out of 13 countries employment growth has been negative and has been significantly below the rate of growth of the labour force in another three. Of the remaining five, two (Mauritius and Botswana) have been notable exceptions to the general economic decline in sub-Saharan Africa. Although these employment figures give only a part of the picture it is widely believed that for most countries in sub-Saharan Africa the employment situation has deteriorated as a consequence of a prolonged period of poor growth. The poor performance of agricultural production in sub-Saharan Africa has led to declining labour productivity and returns to labour in agricultural employment.[2] In addition diverse pieces of information indicate that informal sector employment has grown rapidly while employment and real wages in the modern sector have either stagnated or declined.[3] Available information for the manufacturing sector suggest that the rate of growth of employment has decreased substantially since the mid-

Table 5.1 (b). Employment, sub-Saharan Africa (percentages)

	Growth of labour force (average annual growth)			Employment growth in establishments (average annual growth)		
	1975-80	1981-85	1986-93	1975-80	1981-85	1986-92
Côte d'Ivoire	2.38	2.70	2.54	6.68	– 2.89	– 1.04
Ghana	2.69	2.66	2.85	1.48	11.04	– 13.29
Guinea-Bissau	4.51	1.14	1.49			
Kenya	3.73	3.47	3.63	4.21	3.16	3.48
Madagascar	2.24	1.94	2.17			4.27
Malawi	2.56	2.60	2.61	5.68	3.92	2.74
Mauritius	3.42	3.31	2.24	2.76	1.79	4.02
Nigeria	3.22	2.65	2.80			
Senegal	3.30	1.87	2.00			
Tanzania, United Republic of	2.94	2.79	2.95			
Togo	2.21	2.24	2.39			
Zambia	2.81	3.24	3.42	– 0.69	– 0.95	– 0.13
Benin	2.21	2.04	2.35			
Burkina Faso	1.91	1.94	2.09			
Burundi	1.31	2.02	2.34	6.58	1.35	0.26
Cameroon	1.58	1.81	2.07			
Central African Republic	1.33	1.34	1.64	– 3.36		– 4.69
Congo	2.19	1.83	2.08			
Gabon	0.89	0.61	0.78			
Gambia	1.87	1.24	1.45			
Mali	1.91	2.51	2.68			
Niger	2.04	2.25	2.52			
Sierra Leone	1.01	1.12	1.32	2.80	– 0.06	0.51
Somalia	3.58	2.03	1.52			
Sudan	2.70	2.81	3.00			
Zaire	1.89	2.26	2.41			
Zimbabwe	2.96	2.74	2.90	– 0.76	0.89	1.92
Botswana	2.90	3.50	3.26	7.83	7.12	10.15
Ethiopia	2.03	1.74	2.10			
Lesotho	2.10	1.98	2.08			
Liberia	2.69	2.16	2.53			
Rwanda	3.27	2.78	2.85			
South Africa[2]	1.31	2.77	2.77		0.93	– 0.20

[1] The coverage of establishment surveys with respect to labour force is as follows: Ghana: 8%; Madagascar: 9%; Malawi: 14%; Mauritius: 60%; Zambia: 20%; Central African Republic and Sierra Leone: 3%; Zimbabwe: 40%; Botswana: 50%; South Africa: 55%. [2] Excludes employment in agriculture.

Source: ILO: *Yearbook of Labour Statistics*; World Bank: world tables 1995.

1980s. In view of declining value added in manufacturing production, the slow though still positive increase in employment was possibly due to a substantial drop in real wages.[4]

Although there is no systematic information on employment trends in North Africa and the Middle East, the sharp contraction of the economy that took place in most countries of the region at the end of the oil boom points to a deterioration of the employment situation. High rates of growth in the labour force (table 5.1) have also contributed to increasing unemployment and underemployment. The few countries

Table 5.1 (c). Employment, North Africa and Middle East (percentages)

	Growth of labour force (average annual growth)			Total employment rate			Urban unemployment rate		
	1975-80	1981-85	1986-91	1975-80	1981-85	1986-91	1975-80	1981-85	1986-91
Algeria	3.23	3.60	3.78			20.40			
Egypt	2.40	2.59	2.62	3.80	5.93	8.37			
Iran, Islamic Republic of	3.13	3.30	3.25						
Iraq	4.21	3.70	3.87						
Jordan	0.34	4.39	4.36						
Kuwait	9.57	6.17	3.93						
Morocco	4.09	3.25	3.17						15.55
Saudi Arabia	6.14	4.35	3.60						
Syrian Arab Republic	3.42	3.48	3.77	4.88	4.45	6.30			
Tunisia	3.48	3.11	3.00						
Turkey	1.59	2.30	2.05			8.03		11.53	

Source: ILO, *Yearbook of Labour Statistics*; World Bank, *world tables 1993*

Table 5.1 (d). Employment, Asia (percentages)

	Growth of labour force (average annual growth)			Total employment growth			Total unemployment rate		
	1975-80	1981-85	1986-91	1975-80	1981-85	1986-92	1975-80	1981-85	1986-91
Bangladesh	2.19	2.79	2.99						
India[1]	1.73	2.02	1.92	2.55	1.96	1.38			
Pakistan	2.97	3.24	2.66	3.32	2.07	1.93	3.60	3.74	4.09
Sri Lanka	2.72	1.64	1.51	1.65	−4.84	12.08			
South Asia	**1.91**	**2.18**	**2.05**	**2.61**	**1.85**	**1.62**			
Indonesia	2.17	2.43	2.31	−1.31	2.68	2.09			
Malaysia	3.70	2.95	2.73		3.39	3.41			
Thailand	2.85	2.48	1.93	4.26	2.95	3.17	0.78	2.72	3.13
New NICs	**2.72**	**2.55**	**2.26**	**0.32**	**2.80**	**2.47**	**0.78**	**2.72**	**3.13**
Korea, Republic of	2.44	2.65	2.07	3.68	1.83	3.41	4.00	4.16	2.74
Hong Kong[2]	4.50	2.05	1.91	5.72	7.56	3.79	4.65	3.76	1.76
Singapore	4.19	1.88	0.98	4.95	2.99	3.26	3.82	3.10	3.21
NICs	**3.71**	**2.20**	**1.65**	**4.03**	**2.66**	**3.45**	**4.08**	**4.05**	**2.63**
Fiji	2.69	2.26	1.95	2.85	0.19	2.01		7.40	7.06
Papua New Guinea	1.38	1.80	1.35						
Samoa									
Tonga									
Pacific island economies	**2.04**	**2.03**	**1.65**	**2.85**	**0.19**	**2.01**		**7.40**	**7.06**
Myanmar	2.27	1.94	1.85	2.22	2.29	1.29			
Philippines	2.09	2.54	2.50	1.11	3.47	2.34	4.40	5.78	8.35

[1] Unemployment figures include all applicants for work, including persons in employment. [2] Excludes employment in agriculture.
Source: ILO, *Yearbook of Labour Statistics*; World Bank, *world tables 1995*

for which there are unemployment figures show a rising trend since the mid-1970s (Egypt and Syria in table 5.1). Other countries for which there is scattered information (Algeria, Morocco and Turkey) also show high rates of unemployment. Even in the fast-growing countries of the region (Turkey and Morocco) greater export orientation has not resulted in the creation of productive employment. The expansion of exports has not stimulated investment because it has been based on excess capacity inherited from the previous period of industrialization. Moreover, in the case of Turkey there are estimates that show a declining output elasticity of employment during the period of adjustment.[5] On the other hand, the period of adjustment in these two countries has been accompanied by a reduction in real wages and in the share of wages in value added.

On the whole, therefore, it could be said that it is only the rapidly growing economies in East and South-East Asia that are solidly on the path towards full employment. For most of countries in the other regions of the developing world the serious problems of unemployment, underemployment and low-productivity work are not being reversed. A basic requirement for such a reversal to occur is higher economic growth. As will be seen from table 5.1 labour force growth continues to be high in most developing countries. It is typically between 2.5 to 3 per cent per annum and will remain within this range for some time to come. Given that the employment elasticity of output growth is significantly below unity even in developing countries, high growth is required just to absorb this increase in the labour force.[6] For example, with an employment elasticity of 0.5, a growth rate of 5 per cent is required simply to absorb an increase of 2.5 per cent in the labour force. If the labour force growth is 3 per cent then a growth rate of 6 per cent would be required. As will be seen in table 5.2 many developing countries have not managed to attain such growth rates since 1980. Even if it were possible to increase the employment intensity of growth it would still be desirable to aim for such growth rates in order to allow for the greater increase in labour productivity that is required to reduce underemployment and poverty.

Growth and adjustment

As will be seen in table 5.2, economic growth in developing countries was generally been higher prior to 1980. Between 1980 and 1985 growth rates declined sharply in Latin America and sub-Saharan Africa due to the impact of the international debt problem and the consequent implementation of severe stabilization and structural adjustment programmes. It will also be seen that there has been a recovery in growth rates since then but not to the levels of the pre-crisis period.

There has been a running controversy over the effects of stabilization and structural adjustment programmes on economic growth and the welfare of the poor. While there is little disagreement on the need to restore macroeconomic stability and to implement reforms towards more open and competitive economies, there has been sharp disagreement over the reform strategy to be adopted, especially the pace, timing and sequencing of particular aspects of reform. For some, stabilization programmes have been too drastic, provoking an excessive fall in output and too high a social cost. For others the structural adjustment programmes have led to excessively rapid reforms on too many fronts simultaneously. Trade and other forms of liberalization have caused excessive contraction of domestic output while export gains have been modest because of insufficient attention to structural and other constraints. Essential public

Table 5.2. Macroeconom.. indications (percentages)

Country	Growth of GDP (annual average in US$, 1987)				Gross domestic investment (% of GDP)			Gross domestic savings (% of GDP)			Exports in GDP (% of GDP at constant prices)		
	1975-80	1981-85	1986-91	1994	1975-80	1981-85	1986-91	1975-80	1981-85	1986-91	1975-80	1981-85	1986-91
Latin America													
Bolivia	2.54	−1.52	2.85	4.2	25.22	10.78	12.64	22.30	12.00	7.04	17.76	13.82	17.93
Brazil	6.70	1.22	1.84	4.8	23.52	19.16	20.95	21.43	21.60	23.88	5.64	8.81	10.95
Chile	7.25	1.12	7.12	4.2	19.45	15.76	24.47	17.82	14.10	27.46	24.26	27.88	33.86
Colombia	5.38	2.31	4.28	5.7	18.17	19.80	19.30	20.43	17.82	22.88	13.69	12.62	18.33
Costa Rica	5.25	0.45	4.89	3.5	24.17	25.30	26.85	16.08	24.46	23.39	26.42	28.85	36.59
Jamaica	−2.95	0.17	3.46	3.0	17.72	22.38	26.71	15.13	13.60	23.89	38.37	41.73	50.71
Mexico	6.67	2.07	1.77	3.5	23.18	22.44	21.09	21.05	27.42	20.64	11.01	15.75	19.92
IALC	**6.58**	**1.92**	**2.39**		**22.74**	**20.82**	**21.88**	**20.95**	**22.53**	**22.84**	**9.51**	**12.76**	**16.14**
Argentina	2.80	−2.02	3.17	7.1	26.17	20.56	16.86	29.87	23.48	18.51	7.14	8.64	10.01
Ecuador	6.60	2.29	2.64	4.0	26.13	20.29	20.98	23.47	23.30	21.14	25.02	22.89	29.51
Guyana	−0.62	−4.20	1.39	8.5	30.67	28.20	33.50	20.25	12.12	23.66	96.72	82.46	79.30
Honduras	7.30	1.75	3.53	−1.5	23.25	16.74	21.48	17.35	11.56	16.46	24.30	22.92	21.00
Panama	6.43	2.91	2.24	4.7	27.98	21.98	15.87	23.43	22.24	21.11	32.80	35.60	39.83
Uruguay	4.49	−2.54	3.21	5.0	20.90	15.80	12.78	17.72	17.00	16.19	17.62	21.98	26.48
DALC	**3.98**	**−1.43**	**3.10**		**27.40**	**20.22**	**17.15**	**27.98**	**22.65**	**18.89**	**10.99**	**12.25**	**14.23**
Dominican Republic	4.87	1.62	3.65	4.3	23.83	21.28	23.21	17.70	16.70	18.35	25.10	31.47	35.92
El Salvador	1.23	−1.69	3.06	5.8	20.05	12.46	14.01	18.00	5.98	3.89	20.90	20.95	18.83
Guatemala	5.73	−1.11	3.38	4.0	18.95	13.06	14.37	15.17	10.02	9.40	24.11	18.78	16.88
Haiti	5.74	−0.98	−2.45	−10.6	16.40	16.92	10.89	7.47	5.22	0.40	17.64	19.39	19.30
Nicaragua	−3.25	0.60	−1.97	3.2	15.12	22.04	20.23	12.57	10.00	−3.27	21.21	17.29	16.57
Paraguay	10.79	1.85	3.43	3.5	26.82	24.70	24.00	21.07	19.32	18.96	22.11	20.48	30.23
Peru	2.24	0.47	0.14	13.0	22.62	26.24	19.35	20.30	27.04	17.83	22.51	24.34	17.62
Trinidad and Tobago	8.05	−1.47	−1.46	4.6	29.08	25.50	15.59	39.37	24.26	22.19	20.19	20.84	43.72
Venezuela	2.53	−0.91	3.66	−2.9	35.60	20.06	19.69	35.55	26.26	22.79	26.91	21.38	24.32
NALC	**2.22**	**−0.42**	**2.46**		**26.12**	**20.85**	**19.63**	**27.98**	**22.58**	**18.42**	**24.78**	**22.85**	**23.74**
Antigua and Barbuda		5.32	5.76	4.2									
Barbados	4.58	−0.89	1.43	3.7	22.90	20.34	17.63	11.75	15.96	18.30			
Puerto Rico											59.93	63.62	67.68
Suriname	0.78	−1.52	1.21	−1.0	34.95	18.76	19.69	31.47	7.40	20.96			
Sub-Saharan Africa													
Côte d'Ivoire	4.58	0.51	−0.65	1.7	26.17	18.26	10.70	26.47	21.38	16.09	26.02	40.43	37.63
Ghana	1.41	−0.01	4.61	3.8	8.37	5.64	13.27	7.95	5.04	5.15	29.58	17.20	20.52
Guinea-Bissau	−1.55	6.04	4.87	6.3	20.77	30.68	28.67	−6.30	−1.08	−6.70	29.72	17.37	11.94
Kenya	6.24	2.68	3.73	3.2	23.88	23.40	21.87	19.32	20.48	19.49	27.50	22.01	23.26
Madagascar	1.47	−1.59	1.27	0.2	10.83	9.10	11.75	2.50	1.12	5.02	24.89	18.09	17.97
Malawi	4.98	2.22	2.67	−12.4	27.92	18.66	17.35	15.66	13.96	7.33	24.36	24.05	24.76
Mauritius	4.20	4.69	6.74	4.7	28.45	21.44	28.05	19.98	17.64	25.04	50.06	51.23	67.84
Nigeria	4.07	−2.31	4.49	1.3	26.13	15.30	14.88	26.77	13.60	19.78	39.61	29.05	29.66
Senegal	1.60	3.07	2.27	2.0	16.48	11.32	12.70	6.78	−1.62	6.76	25.50	25.79	24.09
Tanzania, United Rep. of	2.14	0.84	4.85	3.1	24.07	18.46	40.44	14.20	10.90	8.60			
Togo	5.04	−0.05	−1.32	10.7	39.42	24.78	21.96	25.60	19.32	12.35	34.04	35.04	34.52
Zambia	0.39	0.44	1.54	1.4	26.40	15.90	15.16	23.77	12.38	15.24	63.55	49.41	39.35
IALC	**3.75**	**−0.38**	**3.45**		**23.55**	**15.98**	**16.79**	**21.16**	**13.27**	**15.80**	**34.76**	**29.32**	**29.78**
Benin	4.09	4.75	2.17	3.4	17.35	16.46	13.45	−0.22	0.38	3.76	29.88	28.17	22.74
Burkina Faso	4.47	4.54	2.88	1.2	21.62	19.06	21.46	−3.43	−6.06	2.41	13.40	12.47	12.16
Burundi	4.23	5.37	2.63	−6.7	11.78	17.32	17.17	4.32	4.00	1.05	9.08	10.93	9.61
Cameroon	9.88	7.30	−3.48	−3.8	25.13	31.54	19.32	20.97	35.46	17.81	10.37	14.43	23.43
Central African Republic	0.72	2.38	−0.23	6.7	10.90	10.80	11.74	−2.02	−2.10	−0.86	25.34	24.79	17.40
Congo	5.68	10.71	0.18	−6.7	30.97	41.40	18.55	15.57	39.74	18.15	43.20	41.21	47.98
Gabon	0.40	1.85	1.54	1.7	48.28	35.58	29.39	60.03	54.54	35.03	37.61	38.02	45.99
Gambia	2.96	5.05	3.19		20.55	18.82	19.26	2.82	5.66	8.16	60.96	66.74	62.38
Mali	5.40	−2.81	4.56	2.4	16.25	16.90	21.86	0.33	−4.46	4.21	9.74	13.99	16.99
Niger	6.76	−2.96	1.01	4.0	22.27	13.96	10.54	12.06	5.70	7.28	34.79	24.58	19.69
Sierra Leone	0.88	1.02	1.50	3.5	13.50	13.90	11.22	3.27	6.34	8.89	40.55	16.31	12.69
Somalia	4.43	2.76	1.24		27.98	26.66	25.64	−6.00	−12.18	−0.26	11.52	11.34	4.89

Imports to GDP (% of GDP at constant prices)			Trade balance (% of GDP)			Annual rate of inflation				Government current budget balance (% of GDP)			Debt service ratio		
1975-80	1981-85	1986-90	1975-80	1981-85	1986-90	1975-80	1981-85	1986-90	1994	1975-80	1981-85	1986-90	1975-80	1981-85	1986-90
25.65	18.12	20.85	−7.89	−4.31	−2.92	17.98	2692.46	47.66	8.5			1.75	11.35	23.42	14.61
9.97	6.76	7.36	−4.33	2.04	3.59	51.98	153.86	1110.00	929.3	2.90	4.13	−9.22	24.13	34.85	16.28
29.96	30.63	31.86	−5.70	−2.75	2.00	82.47	21.49	18.38	8.9	5.73	0.11	3.17	14.50	44.25	17.73
11.16	12.65	12.92	2.52	−0.03	5.41	24.46	22.39	25.66	22.5	3.37	−0.56	1.51	7.75	20.17	20.73
34.90	26.51	39.08	−8.28	2.34	−2.49	8.20	37.36	18.17	17.3	−0.45	0.74	1.95	10.00	29.40	13.30
35.75	37.32	53.19	2.62	4.41	−2.48	22.45	16.67	27.09	30.0	−0.04	−2.50		13.38	23.18	22.70
17.93	15.72	22.61	−6.92	0.02	−2.69	21.36	62.38	53.35	7.1	1.82	−2.93	−5.86	36.79	37.85	30.29
14.16	**11.81**	**14.57**	**−4.67**	**0.95**	**1.58**	**41.20**	**130.63**	**612.59**		**2.71**	**1.28**	**−6.41**	**25.77**	**34.86**	**20.96**
7.73	8.01	8.79	−0.60	0.63	1.22	211.15	382.39	770.67	3.7	−0.87	−1.22	0.19	13.20	35.59	30.27
36.99	28.57	26.01	−11.97	−5.69	3.51	11.73	28.06	47.90	25.4	0.91	0.95	4.07	8.07	27.24	16.13
121.95	90.95	78.83	−25.23	−8.48	0.47	12.86	19.66	12.73	14.0	2.48	−10.34		6.18	9.67	12.14
33.51	25.86	25.75	−9.20	−2.94	−4.75	9.85	6.95	12.25	28.8	3.51			7.01	13.85	15.03
39.77	35.13	32.77	−6.96	0.47	7.06	6.91	3.25	0.71	1.4	−0.68	−1.55	1.33	42.16	102.36	36.11
18.54	17.82	22.17	−0.92	4.16	4.32	56.74	45.95	77.46	44.1	0.71	−2.13	1.28	11.06	23.48	20.72
13.16	**12.12**	**12.62**	**−2.18**	**0.13**	**1.61**	**170.79**	**386.86**	**614.92**		**−0.47**	**−1.28**	**0.64**	**13.49**	**35.92**	**28.20**
35.36	37.37	36.74	−10.26	−5.90	−0.82	10.00	16.90	29.83	14.3	5.50	1.40	6.69	7.53	15.36	16.18
34.97	28.00	26.76	−14.07	−7.06	−7.93	12.83	14.74	20.30	8.9	3.61	−0.04	1.07	3.68	8.65	12.67
35.81	22.33	23.51	−11.70	−3.55	−6.62	10.70	7.67	20.97	11.6	2.47	0.20	0.78	2.73	7.92	10.94
28.54	28.97	35.53	−8.90	−9.67	−16.23	8.35	9.10	10.18	42.6	−1.07	−0.23	−3.73	2.13	3.83	4.14
12.05	14.82	14.98	9.16	2.47	2.00	20.45	66.93	3630.92	12.4	−0.14	−8.22	−4.14	8.14	14.32	15.89
40.16	34.82	41.80	−18.05	−14.34	−8.58	15.03	15.94	24.80	18.3	3.38	1.69	2.98	7.64	15.54	18.45
21.39	19.46	15.31	1.12	4.88	2.51	51.05	104.93	1530.34	15.3	1.05	−0.99	−1.26	21.81	15.33	8.81
20.98	28.55	42.85	−0.79	−7.71	0.87	12.98	12.42	8.72	8.8	21.80	7.06	−0.93	0.87	3.56	8.45
25.15	23.31	21.66	1.76	−1.93	2.66	11.28	11.12	37.25	70.8	10.01	8.20	2.96	3.92	11.84	19.51
26.28	**23.96**	**23.32**	**−1.56**	**−1.92**	**0.42**	**19.28**	**31.13**	**431.31**		**6.94**	**4.18**	**1.62**	**7.55**	**12.00**	**15.48**
									3.5						
						10.08	7.75	4.03		2.89	2.93	2.91	2.51	4.95	17.99
64.56	61.41	64.50	−4.53	2.21	3.18	10.22	11.29	3.01							
						11.52	7.01	39.38	368.5	10.73	−12.98	−20.72			
30.70	29.41	25.16	−4.68	11.01	12.47	16.75	5.64	3.63	26.0	5.02	1.11	−0.48	8.61	27.79	15.75
32.98	18.79	25.22	−4.40	−1.59	−4.70	70.03	62.33	26.41	24.9	−3.11	−1.99	2.73	2.33	4.99	6.45
56.31	58.17	48.24	−27.59	−40.80	−36.39			58.23	15.2		7.49	16.02	6.38	9.69	22.42
45.99	26.10	26.67	−18.49	−4.09	−3.41	13.01	13.39	18.41	28.8	2.50	−0.59	0.75	7.98	15.55	19.97
40.25	30.27	21.43	−15.37	−12.18	−3.56	9.38	20.41	13.78	39.1			2.52	2.89	13.47	29.70
53.86	38.87	35.61	−29.51	−14.82	−10.85		13.14	19.04	34.6	4.16	1.47	1.43	7.82	13.33	9.83
61.40	44.98	67.03	−11.34	6.24	0.81	17.42	9.11	7.45	9.4	−0.77	−2.09	4.45	2.42	8.41	4.01
63.43	70.32	24.89	−23.82	−41.27	4.77	16.31	19.75	30.51	57.0	9.06	2.94	2.71	0.95	7.94	14.83
32.90	32.58	30.02	−6.06	−6.80	−5.93	6.85	11.94	−0.18	32.0	1.90	0.63		7.23	8.98	15.09
						13.64	30.22	25.87	29.0	0.83	2.00		8.66	14.58	19.13
44.83	39.92	44.63	−10.80	−4.89	−9.71	10.88	6.97	0.62	41.4	12.09	6.05	7.05	4.62	15.81	13.92
60.95	33.84	31.74	2.60	15.57	7.61	15.25	20.69	109.35	53.0	−4.11	−5.67	−3.01	7.90	8.42	11.10
51.27	**48.99**	**27.44**	**−16.51**	**−19.68**	**2.35**	**19.12**	**20.15**	**23.75**		**5.21**	**1.36**	**2.01**	**4.04**	**11.78**	**15.13**
62.39	53.48	32.81	−32.51	−25.31	−10.07				38.6	9.60			4.56	14.83	13.11
32.99	30.27	31.61	−19.59	−17.79	−19.45	11.41	7.54	−0.16	24.7	2.14	1.27	1.25	4.73	11.27	11.42
24.82	26.37	24.40	−15.75	−15.44	−14.80	15.33	8.86	6.89	14.7		6.92		1.39	5.04	15.42
22.64	19.50	21.85	−12.27	−5.07	1.58	10.64	12.63	3.65	12.7	4.85	8.82	2.86	5.56	15.97	14.46
35.35	36.27	29.18	−10.01	−11.47	−11.75		10.22	−1.84	24.5		0.03		1.70	5.23	9.74
67.88	70.81	38.67	−24.67	−29.60	9.29	9.43	11.26	2.71	56.9		14.29		5.88	9.68	8.80
38.79	55.39	39.51	−1.18	−17.37	6.47	13.02	5.81	3.78	36.1	2.57	20.47	8.69	3.93	3.39	5.17
122.89	76.20	91.83	−61.93	−9.46	−29.54	10.25	13.57	17.10	4.0	5.82	2.81	9.63	0.63	4.05	14.08
20.25	30.91	33.74	−10.51	−16.92	−16.74				33.8	1.69	9.04	9.24	1.75	5.27	4.74
25.18	27.55	18.62	9.61	−2.97	0.98	14.89	7.90	−3.55	35.6	3.92			5.97	17.39	13.95
50.84	25.89	14.47	−10.28	−9.58	−1.87	14.12	52.39	82.23	18.4	0.50	−3.73	−2.61	4.31	3.96	2.16
32.60	39.97	23.21	−21.08	−28.63	−18.32	23.56	46.60	48.62		1.02			1.29	4.50	5.76

Table 5.2. *(cont.)*

Country	Growth of GDP (annual average in US$ 1987)				Gross domestic investment (% of GDP)			Gross domestic savings (% of GDP)			Exports to GDP (% of GDP at constant prices)		
	1975-80	1981-85	1986-93	1994	1975-80	1981-85	1986-93	1975-80	1981-85	1986-93	1975-80	1981-85	1986-93
Sudan				5.5	16.75	14.28	13.95	7.72	2.64	6.53	5.27	4.85	3.18
Zaire	-1.73	1.81	-2.02	-7.6	14.72	10.22	14.07	12.03	9.42	12.40	13.51	19.03	25.02
Zimbabwe	1.00	4.96	2.46	4.5	17.78	19.78	21.58	18.68	16.86	20.97	27.70	25.63	29.18
OALC	**3.93**	**4.00**	**0.15**		**22.00**	**21.49**	**18.22**	**15.33**	**16.58**	**13.34**	**18.58**	**19.03**	**21.87**
Botswana	13.16	10.20	8.28	2.8	36.60	34.20	30.17	19.10	25.56	42.20			70.33
Ethiopia				1.3									
Lesotho	10.21	1.78	5.90	16.7	30.45	43.44	61.69	-66.92	-82.40	-53.57	15.13	14.02	16.21
Liberia				2.2							47.09	45.40	44.12
Rwanda	10.29	3.23	0.40		14.55	15.54	13.94	8.00	5.58	-0.54	5.78	5.53	6.54
South Africa	3.15	1.28	0.77	2.3	26.28	26.76	17.56	30.83	29.36	23.42	33.61	29.36	31.93
NALC	**5.20**	**4.12**	**3.64**		**26.97**	**29.98**	**30.84**	**-2.25**	**-5.47**	**2.68**	**25.40**	**23.58**	**33.83**
North Africa and the Middle East													
Algeria	6.24	5.30	0.16	-0.2	44.80	36.04	29.95	38.67	38.68	30.27	16.59	13.99	15.43
Egypt, Arab Republic of	10.98	7.01	2.22	1.3	30.50	28.50	20.81	15.55	15.12	9.28	24.05	18.38	22.50
Iran, Islamic Republic of	-3.73	6.00	2.12	1.6	26.90	21.44	26.81	33.45	21.54	24.09	8.84	3.92	5.14
Jordan		4.19	2.10	5.7		28.50	26.63		-12.33	-10.14			
Kuwait				1.1							68.72	52.50	51.08
Morocco	6.50	3.35	2.83	11.5	26.93	26.14	22.79	12.30	14.66	17.70	21.30	21.07	22.91
Saudi Arabia	8.13	-5.56	4.63	-0.1	24.93	25.38	20.57	57.55	29.08	19.89			
Syrian Arab Republic	6.58	3.08	2.77	5.5	28.83	23.60	17.00	12.13	10.40	9.10	15.86	12.49	14.16
Tunisia	6.48	4.20	3.59	3.4	29.80	30.44	24.90	22.62	21.36	19.52	34.79	32.89	39.06
Turkey	2.82	4.77	5.21	-5.5	22.12	20.54	24.75	15.83	16.46	22.73	4.83	12.02	16.46
Asia													
Bangladesh	4.03	5.31	4.05	4.4	10.85	13.94	12.61	1.55	1.86	4.16	6.33	6.71	8.36
India	3.22	5.37	4.93	4.9	21.27	22.72	24.88	20.27	20.00	22.83	6.36	6.09	6.91
Pakistan	6.28	6.78	5.53	3.9	17.83	18.70	19.19	7.27	7.88	11.25	10.03	11.40	14.29
Sri Lanka	5.24	5.58	4.00	5.6	20.97	27.08	23.04	13.40	13.68	13.28	26.45	24.87	26.39
South Asia	**3.64**	**5.52**	**4.93**		**20.34**	**21.91**	**23.57**	**17.73**	**17.60**	**20.39**	**7.17**	**7.89**	**8.19**
Indonesia	7.54	5.07	6.31	7.9	24.33	28.00	30.36	29.57	30.02	32.10	36.64	23.05	22.78
Malaysia	8.64	5.17	7.42	8.7	26.78	34.26	29.91	32.58	31.54	34.82	49.95	51.84	75.45
Thailand	7.82	5.43	9.47	8.5	27.02	28.78	35.55	22.07	24.34	32.50	19.24	22.30	34.30
New NICs	**7.86**	**5.21**	**7.65**		**25.78**	**29.55**	**32.10**	**27.54**	**28.33**	**32.80**	**33.23**	**28.67**	**37.60**
Korea, Republic of	8.72	7.98	8.83	8.4	29.73	29.44	33.74	25.23	28.14	36.26	26.65	32.80	37.75
Hong Kong				5.7							78.18	92.68	156.33
Singapore				10.1							128.21	153.08	199.74
NICs	**8.72**	**7.98**	**8.83**		**29.73**	**29.44**	**33.74**	**25.23**	**28.14**	**36.26**	**77.68**	**92.85**	**131.27**
Fiji	4.22	0.19	3.30	3.3	25.00	23.80	15.31	21.20	18.28	17.11	43.44	45.56	
Papua New Guinea	1.11	1.46	5.72	3.0	21.92	27.12	23.25	18.57	10.04	17.21	36.57	39.03	43.79
Tonga													
Western Samoa	2.39	-0.88	0.03	-5.5	39.75	30.30	33.30	-10.90	-7.02	-9.13	16.38	15.05	18.38
Pacific island economies	**2.57**	**0.26**	**3.82**		**28.89**	**27.97**	**23.95**	**9.52**	**7.10**	**8.40**	**32.13**	**33.21**	**31.09**
Myanmar				6.3	15.88	18.76	12.59	12.12	13.50	10.99	2.71	2.83	3.84
Philippines	6.04	-1.16	3.18	4.3	31.22	24.42	20.45	26.33	21.52	18.22	18.77	23.82	29.76

Notes: According to World Bank 1992, countries are classified as: IALC: intensive adjustment lending countries; OALC: other adjustment lending countries; NALC: non adjustment lending countries.

IALC, OALC, NALC: weighted averages by GDP (except NALC in sub-Saharan Africa where averages for first 6 columns are unweighted).

NICs: newly industrialized countries and areas.

South Asia and new NICs: weighted averages by GDP; NICs and Pacific island economies: unweighted averages.

The debt service ratio is the ratio of long-term interest payments to the value of exports.

Imports to GDP (% of GDP at constant prices)			Trade balance (% of GDP)			Annual rate of inflation				Government current budget balance (% of GDP)			Debt service ratio		
1975-80	1981-85	1986-93	1975-80	1981-85	1986-93	1975-80	1981-85	1986-93	1994	1975-80	1981-85	1986-93	1975-80	1981-85	1986-93
9.73	14.29	7.89	-4.46	-9.44	-4.71	18.89	32.09	73.02	102.0	1.04	1.95		7.40	9.51	4.29
13.23	19.10	26.95	0.28	-0.07	-1.93	69.16	44.94	1084.46	2375.97	0.00	0.00	0.00	8.25	15.65	8.86
27.86	30.65	30.90	-0.16	-5.02	-1.72	10.09	15.11	19.68	23.2	-5.20	-2.37	-1.70	0.41	8.08	11.81
26.54	**29.22**	**24.99**	**-7.96**	**-10.20**	**-3.12**	**20.85**	**20.98**	**160.30**		**1.59**	**5.32**	**2.53**	**4.95**	**10.78**	**9.46**
		63.92			6.41	11.86	10.94	11.67	11.1	14.35	21.09	28.61	1.97	2.28	2.31
						16.00	7.77	7.20	1.5				3.74	6.88	17.39
142.04	151.45	125.44	-126.82	-137.44	-109.23	14.46	13.27	14.54	9.5	9.24	8.09	13.50	1.56	13.30	13.13
43.27	32.56	28.30	3.82	12.84	15.82	9.08	3.31	6.94	10.0	6.29	0.03	-1.21	2.48	2.64	1.19
14.23	18.26	18.25	-8.44	-12.73	-11.71	11.40	6.55	6.59	64.0	3.24		2.06	0.77	2.48	6.36
28.76	24.49	23.57	4.85	4.87	8.36	11.88	14.01	14.44	9.0	2.35	0.46	-1.55			
57.07	**56.69**	**51.90**	**-31.67**	**-33.11**	**-18.07**	**11.96**	**13.46**	**13.91**			**2.78**	**1.08**	**-0.54**	**4.25**	**7.80**
24.02	23.56	13.24	-7.43	-9.57	2.20	11.83	9.17	16.22	22.5				8.35	11.89	17.37
56.23	44.17	31.88	-32.18	-25.79	-9.38	12.94	14.07	18.09	8.1	0.06	2.29	3.71	13.33	30.84	40.49
7.74	6.91	5.12	1.10	-3.00	0.03	16.28	15.91	21.21	13.91	6.83	0.76	-0.52	3.06	0.86	0.46
						11.67	5.40	8.15	3.6		3.89	3.48	8.96	18.19	25.24
27.05	58.96	41.01	41.67	-6.48	10.07	7.56	4.51	4.20	4.7	50.92	39.68	-30.75			
36.00	27.26	28.50	-14.70	-6.19	-5.59	9.71	9.88	5.34	5.1	2.83	-0.16	2.47	15.14	26.90	24.63
						9.40	-0.12	0.64	0.6						
40.95	28.90	23.43	-25.09	-16.41	-9.27	10.41	13.06	23.73	15.0	13.31	6.12	6.22	3.32	3.44	2.77
44.52	48.12	43.54	-9.73	-15.22	-4.48		8.08	6.73	4.7	8.43	8.22	4.56	7.53	12.03	13.02
12.60	12.88	18.71	-7.77	-0.86	-2.26	51.72	38.43	59.11	106.3	3.71	0.32	-1.19	11.18	19.30	20.95
15.11	16.82	16.35	-8.78	-10.11	-7.96	8.10	11.86	7.43	3.2			-0.79	6.33	8.77	9.40
7.05	8.70	8.61	-0.69	-2.61	-1.70	4.16	9.35	9.26	10.2	1.12	0.28	-1.00	5.43	9.99	19.11
26.13	21.39	19.69	-16.09	-9.96	-5.40	8.73	7.17	8.08	12.8	0.90	0.53	-1.10	10.94	10.25	9.58
31.12	37.07	32.83	-4.68	-12.19	-6.44	10.31	12.18	12.26	8.4	0.64	4.18	1.60	3.24	7.32	7.30
10.05	**11.09**	**10.72**	**-2.88**	**-4.00**	**-2.53**	**4.99**	**9.30**	**9.09**		**1.08**	**0.39**	**-0.95**	**6.04**	**9.90**	**17.32**
21.76	26.19	18.73	14.87	-3.13	4.05	14.66	9.74	7.94	8.5	7.77	9.95	8.48	5.62	8.12	13.28
43.92	55.77	68.79	6.03	-3.93	6.66	4.52	4.69	2.71	3.7	2.89	3.14	3.39	2.73	6.80	5.03
28.39	27.09	37.41	-9.15	-4.79	-3.11	9.86	4.99	4.11	5.0	0.72	-0.23	4.48	4.94	11.28	7.00
28.62	**32.55**	**35.54**	**4.60**	**-3.88**	**2.06**	**10.90**	**7.04**	**5.52**		**4.29**	**4.97**	**6.03**	**4.79**	**8.96**	**9.38**
29.96	31.39	37.03	-3.32	1.41	0.72	17.38	7.34	5.95	6.3	3.34	3.11	3.55	6.70	9.56	3.74
76.75	92.72	153.71	1.43	-0.03	2.63	8.35	9.24	8.08	8.0						
135.16	158.35	197.75	-6.95	-5.28	1.98	3.72	3.27	1.82	3.1	8.19	9.99	10.41			
80.63	**94.15**	**129.50**	**-2.95**	**-1.30**	**1.78**	**9.82**	**6.62**	**5.28**		**5.77**	**6.55**	**6.98**	**6.70**	**9.56**	**3.74**
46.34	43.18		-2.90	2.38		9.37	6.93	6.27	1.5	2.93	2.03	1.87	2.75	8.52	6.47
52.97	57.23	45.56	-16.40	-18.20	-1.80	7.16	6.52	5.24	2.9	3.55	0.43	1.13	5.33	13.32	11.76
						12.42	10.48	8.70		16.73	19.58	19.88	1.25	3.48	4.53
76.20	65.92	65.15	-59.62	-50.67	-46.77	13.15	15.24	6.18	18.4		13.65		9.05	9.68	14.14
58.50	**55.44**	**55.37**	**-26.38**	**-22.23**	**-24.28**	**10.52**	**9.79**	**6.60**		**7.74**	**8.92**	**7.63**	**4.60**	**8.75**	**9.23**
7.91	9.04	5.91	-5.20	-6.21	-2.07	4.29	4.59	22.62	22.2	2.71	4.22	-0.34	6.87	15.74	19.28
22.12	23.37	31.56	-3.35	0.45	-1.80	12.43	21.36	9.36	9.1	2.78	2.74	0.97	8.09	17.87	19.56

Source: World Bank: world tables 1995; 1994 figures for Argentina, Brazil, Chile, Mexico, Peru, Uruguay and Venezuela: ECLAC: *Panorama Económico de América Latina*; 1995: for other countries, IMF: *World Economic Outlook*, May 1995.

investment has been cut back too far and the developmental role of the State has been shrunk too much, to the detriment of growth.

It is not feasible to enter into this vast and complex debate in this short report. The empirical evidence required to resolve particular aspects of the debate satisfactorily are rarely available, and in any case there are severe methodological difficulties involved. At the heart of the methodological difficulty is the problem of establishing a direct cause-and-effect link between particular adjustment policies and observed outcomes, since the latter are typically affected by many other variables such as the external economic environment and the level of aid flows. There is also the tricky problem of the counterfactual. Observed outcomes have to be judged against hypothetical alternative outcomes in the absence of reform or with the adoption of different policies.

Rather than pronouncing on the debate, what will be done instead is to review how economic performance has evolved since the beginning of the adjustment process since the early 1980s, distinguishing between countries which have undergone intensive adjustment and those that have not. This will at least provide an indication of the nature and magnitude of the adjustment problem that still remains. Evaluation of adjustment policies in this section concentrates on the regions where the debt crisis and subsequent policies of structural adjustment are most relevant, namely, Latin America and sub-Saharan Africa.

In Latin America, countries that have undertaken intensive policies of structural adjustment have not been able to restore the high rates of growth attained during the 1970s.[7] Contraction in the annual rate of growth of GDP in the difficult years 1981-85 was not as drastic in intensive-adjusting countries as it was for other adjusting or non-adjusting countries in the region. Yet, on average, the intensive adjusters have had the lowest average rates of GDP growth in Latin America in the post-adjustment period 1986-93. This is due to the poor performance of Bolivia, Brazil and Mexico whose economies showed low rates of growth in spite of the implementation of intensive policies of structural adjustment. Chile, Colombia, Costa Rica and Jamaica had a better record in re-establishing their 1970s growth rates. In 1994 adjusting countries improved their rates of growth, partly financed by large inflows of capital to the region (Argentina and Mexico were the main beneficiaries of larger portfolio investment which supported growth rates of 7.1 and 3.5 per cent respectively), although countries such as Brazil, Chile, Colombia and Uruguay also experienced high rates of growth. By 1995, however, prospects of growth in the region were substantially reduced, partly as a result of the Mexican crisis and the difficulties in Argentina in continuing to finance growth through large short-term capital inflows. Growth in most other countries in the region is also expected to decrease in 1995; according to projections made by ECLAC, Chile is the only country that is expected to continue expanding in 1995.[8]

In sub-Saharan Africa countries undertaking structural adjustment policies show mixed results. Taken together the intensive adjusters have shown a better record in restoring rates of GDP growth similar to those experienced during the 1970s. Results are not uniform, though. Ghana, Guinea-Bissau, Mauritius, Senegal, the United Republic of Tanzania and Zambia have been able to restore their pre-adjustment growth rates. However, given that these latter rates were very low to begin with in Senegal and Zambia, this test is not very meaningful in these cases. Per capita growth remained negative in these two countries between 1986 and 1993. Moreover, in the

other countries, except Mauritius, growth has remained below 5 per cent per annum. There are four other intensive-adjusting countries, however, (Côte d'Ivoire, Kenya, Malawi and Togo) where structural adjustment programmes have been less successful in restoring growth. For countries classified as "other adjusting countries", conditions for growth have actually deteriorated. The only exceptions are Gabon, Gambia, Sierra Leone and Zimbabwe whose GDP growth rates were slightly better in 1986-93 than they were in the 1970s. For the other 11 countries in this group economic performance has been poor.

One of the main aspects of policy advice on structural adjustment was the liberalization of external trade to produce a more outward-oriented structure of production. The degree of openness (measured as the sum of exports and imports to GDP) increased in many cases in adjusting countries. In the intensive-adjusting countries in Latin America this ratio increased from 24 per cent in 1975-80 to 31 per cent in 1986-1992 while in the other adjusting countries it increased from 23 to 27 per cent over the same period. However, in spite of this increasing share of exports in GDP it should be noted that the rate of growth of exports has been no more than half the level in the 1970s.[9] The increasing export share occurred, for the most part, in the context of significantly lower GDP growth in the 1986 to 1993 period.

Results for Africa have been more disappointing. On average, there was a decline in the degree of openness in intensively-adjusting countries in the post-adjustment period. The ratio of imports plus exports to GDP was 86 per cent in 1975-80 and declined sharply to 57 per cent in 1986-93. The other adjusting countries were able to maintain the same ratio before and after structural adjustment. It was only the non-adjusting countries that actually showed a slight improvement in their degree of integration into the international economy. These conditions did not help the restoration of balance-of-payments equilibrium in adjusting African countries which continued to show large current account deficits.

For countries in North Africa and the Middle East the end of the oil boom brought about the collapse in the inward-looking strategy of industrialization, heavily financed by oil revenues. Since the early 1980s countries in the region developed large internal and external imbalances. The high rates of growth experienced by most countries in the late 1970s were substantially reduced in the early 1980s. And in the subsequent period (1986-93) only Iran and Turkey had surpassed their growth rates of the late 1970s.

Economic contraction in the region brought about a drastic reduction in savings and investment rates that have jeopardized the prospects of future growth. As may be seen in table 5.2, IMF estimates for 1994 point to a further reduction in the rate of growth of GDP in the region (the only exceptions being Jordan, Morocco and Syria). Turkey and Morocco adopted comprehensive policies of structural adjustment in the 1980s and are usually referred to among the successful cases of adjustment with growth. Fast growth in the economy was largely due to the fast expansion of exports (especially manufacturing). Whether recent growth trends may be sustainable over the long term is still an open question. In spite of a large increase in savings in Morocco, investment rates are still below t[h]eir pre-adjustment level. Conditions in Turkey, on the other hand, are more difficult. Increasing exports have been accompanied by a larger increase in imports, inflation rates have been on the rise since adjustment started, and external debt has also increased substantially. Overall, growth estimates for 1994 show a sharp contraction.

Programmes of structural adjustment were explicitly designed to restore the conditions necessary for long-term development. According to proponents of these policies more open economies, with less government interference, would "create a virtuous circle of growth in exports and output, increased savings, and self-financed investment".[10] However, in Latin America, the implementation of structural adjustment programmes has done little to restore the level of investment that intensive-adjusting countries had as a group in the 1970s. In spite of a modest improvement in the rate of savings, the level of investment in 1986-93 actually declined as a proportion of GDP.[11] In almost all other adjusting countries the decline in both savings and investment rates was particularly severe. In sub-Saharan Africa the deterioration of average savings and investment rates was also large for both intensive and other adjusting countries. Burkina Faso, Burundi, the Central African Republic, Ghana, Guinea-Bissau, Madagascar, Mali, Mauritius, the United Republic of Tanzania and Zimbabwe were able to maintain investment rates slightly above their 1970s rates during the post-adjustment period. But in three of these countries the post-adjustment investment ratio was still below 14 per cent and, more to the point, in all but two of them gross domestic savings remained below 10 per cent of GDP. All other 17 countries experienced a substantial reduction in the ratio of investment to GDP.

The above review thus shows that for many countries the restoration of high and sustained growth still remains elusive. The requirements for growth include the meeting of certain minimum conditions such as political and social stability, an adequately functioning institutional framework (e.g. legal system, financial institutions, public administration), and a minimum level of macroeconomic stability. Where these preconditions are not met standard prescriptions for structural adjustment are unlikely to be enough. The capacity to implement them is absent and, even if implemented, the expected response may not be forthcoming because of inadequate institutions. This is why the creation of the minimum conditions for growth has to remain central to the development agenda.

This can be illustrated in the case of sub-Saharan Africa. These countries can be classified by filtering them through two conditions which are widely accepted as necessary for growth: a minimal degree of social and macroeconomic stability.[12] The idea is that these filters form a hierarchy: without a minimum of social stability there is little point worrying about macroeconomic stability. Similarly, even with adequate social order, if there is macroeconomic chaos there is little point worrying about, say, allocative efficiency.

This classification reveals that six sub-Saharan countries (Angola, Burundi, Liberia, Rwanda, Somalia and Sudan) are engaged in or emerging from civil war. The costs of civil war arise partly from the increased military expenditure, partly from the damage done by military action, and partly from the breakdown of normal economic relationships. These countries (with a combined population equivalent to 11 per cent of the total for sub-Saharan Africa) clearly do not have the minimal level of social order necessary for economic growth.

The next filter concerns the macroeconomic environment. The filter here is based on a simple average of four aspects of the macroeconomic environment: inflation, fiscal balance net of grants, external balance net of grants, and debt service management. For example, inflation policy is not deemed to be even minimally adequate at an inflation rate above 25 per cent with no significant deceleration over the

past three years. These criteria have been set at a genuinely minimal level such that most low-income countries satisfy it; among non-African IDA-receiving countries 85 per cent do indeed meet the criteria.

The following African countries which satisfy the condition of peace currently fail to meet the requirement of macroeconomic stability: Comoros, Equatorial Guinea, Madagascar, Malawi, Mozambique, Niger, Nigeria, Sao Tome and Principe, the United Republic of Tanzania, Togo and Zaire. This group covers 225 million people, which is 40 per cent of the population of sub-Saharan Africa. As with social disorder, one casualty of deep macroeconomic disorder is economic statistics, so it is not possible to produce a post-1992 growth rate for this aggregate, but the broad inference of stagnation or decline in per capita incomes seems likely. For example, in 1992, the last year for which national accounts are available for Zaire, the economy declined by 10 per cent.

Hence, just over half of the population of sub-Saharan Africa lives in territory which is either simply unsafe or is subject to severe macroeconomic instability (or both). In this half of Africa we do not need deep explanations in terms of economic policy as to why growth is low; we need deep analyses as to why governments are not supplying social order and a minimum adequate macroeconomic environment.

Turning to Latin America and the Caribbean, it could be argued that there is a fairly stable social and political environment, with the sole exception of Haiti. Macroeconomic conditions by contrast remain highly unstable. In spite of various attempts to restore macroeconomic stability, at least for the last decade and a half, the region has still experienced persistent inflation and a recurrent balance-of-payments crisis in some of the largest countries. This will be apparent from examining the four standard indicators of macroeconomic stability shown in table 5.2: inflation rates, fiscal and trade deficits, and debt management. It will be seen that high inflation is still a characteristic of more than 10 countries in the region and many of these also perform poorly on the other indicators. Clearly, macroeconomic stability remains a top priority in the economic agenda of many Latin American countries.

Economic reform and employment

As argued in the previous section it is important to find ways of ensuring minimum conditions for growth before the benefits of economic reforms can be reaped. In the case of those African countries which fail to meet these minimum conditions international support will be required to achieve social order and to strengthen basic economic and political institutions. But moving beyond these countries there are key issues of economic reform which have to be faced. Many developing countries in all regions have adopted programmes of economic reform in the quest for higher growth and increased employment creation. The successful attainment of these objectives is of critical importance for their future employment prospects, and issues relating to the design and implementation of economic reforms therefore merit special attention in this report.

A basic objective of these economic reform programmes is to adapt to the increasing globalization of the world economy. The rapid growth of trade and investment flows is creating expanding opportunities for developing countries to increase their rates of growth of output and employment creation. The liberalization of world trade provides potential export markets while the attraction of direct foreign

investment will provide jobs, access to technology, and other spillover benefits. The experience of the economic successes in East and South Asia illustrates how the harnessing of these opportunities can be a powerful engine for growth and job creation. In general, therefore, developing countries need to shift to outward-looking strategies and emphasize the strengthening of their international competitiveness. This will require various measures of economic liberalization, and the maintenance of macroeconomic stability and policies to improve the allocation of resources in the economy.

But there is no "ideal" prescription. No single policy environment holds a monopoly for economic success. For example the three major successful economies, Japan, Germany and the United States, have differences in the degree of regulation, in the share of public expenditure in GDP, and in labour market institutions. This is why structural adjustment has proved controversial; if a particular set of policies are postulated as ideal then it is readily open to dispute.

A basic point of difference in the choice of a strategy for economic reform and promoting growth lies in the role of the State. There are two competing models. One is that of a minimalist State, delivering a "level playing-field" in terms of economic institutions and the policy environment, while the other is that of a "development State", which selectively promotes industries and keeps a firm control over the pace, timing and sequencing of economic reforms. In the case of the East Asian newly industrializing countries and areas (NICs), Hong Kong has exemplified the first model and the Republic of Korea the second, and both have been outstanding economic successes. The choice between these two models depends to a large extent on whether the socio-economic preconditions and the administrative capacity to implement the development State model exist. These are quite demanding conditions. A high degree of social equity is required to ensure that a strong State acts in the general interest and eschews predatory behaviour. In addition, an honest, well-trained and efficient civil service is required to ensure that economic interventions really enhance the functioning of markets and improve outcomes in term of both efficiency and equity. But where these preconditions exist, or can be developed within a reasonable time-frame, it would be unwarranted to rule out the choice of the development state model on ideological grounds.

This is because developing countries are often characterized by market imperfections and high inequality in the distribution of income and assets. That being so, there are several important rationales for an active role of the State in the implementation of economic reforms. The objectives of reform are unlikely to be achieved if the role of the State is confined to that of getting prices right, deregulating markets and withdrawing from direct economic production. As will be discussed below, purely market reforms often need to be supplemented by public investment and other measures to strengthen the supply response of producers to new economic incentives and to ensure an equitable distribution of the benefits from reform.

A key problem that is often encountered in economic reform programmes is that, with economic liberalization, job destruction in uncompetitive activities occurs immediately whereas job creation in new competitive activities comes more slowly. There is thus a serious problem of transitional unemployment or increased underemployment. There are several reasons for this. A basic one is that capital stock is fixed in the short run and hence, even in the best of circumstances, job creation can only come after a time-lag equivalent to the gestation period for new investment.

There are, in addition, other obstacles. The banking system may not respond swiftly enough to the needs of new producers, especially medium and small enterprises, for investment funds and working capital. There may be bottlenecks in essential infrastructure such as power and transportation which can inhibit new investment. Similarly there may be shortages of skilled labour that have to be overcome before new investment becomes feasible. For all these reasons the supply response to the new economic opportunities created by economic reform is likely to be low, hence aggravating the transitional employment problem.

There is thus a need for public investment to relieve bottlenecks in infrastructure, for measures to promote training and retraining[13] in new skills that are in demand, and for financial reforms to improve the access of producers to credit. In addition, measures such as tax credits, investment incentives and export promotion may be necessary in order to strengthen the supply response to new economic opportunities, especially in export markets.

It may also be necessary to manage the pace and sequencing of economic reforms in such a way as to reduce the extent of job losses. Instantaneous reforms on all fronts or a "big-bang" approach is not necessarily always the optimal strategy. Where the pre-reform situation is characterized by high levels of protection and market distortions and by high levels of inequality, a "big-bang" approach is likely to lead to socially unacceptable increases in unemployment, underemployment and poverty. This will in turn compromise the political and social sustainability of the economic reform programme. In contrast, a phased and more gradual implementation of the reforms offers several advantages. It allows more time for the building of political and social consensus around the reform programme as well as for the implementation of measures to strengthen the supply response to new economic opportunities. More time will also be available for the implementation of inherently slow and difficult, but nonetheless essential, institutional reforms such as the strengthening of administrative capacity, the streamlining of the tax system, and privatization. A particularly important consideration is that in many developing countries the capacity to design and implement programmes to compensate for the negative effects of economic reform is typically weak. It is imperative to strengthen this prior to the adoption of drastic programmes of economic reform. The experience with the first generation of structural adjustment programmes showed that, without a realistic assessment of the capacity to implement compensatory programmes, the aim of containing the social costs of adjustment, however well-intentioned, becomes no more than an irresponsible exercise in wishful thinking.

Gradualism should not, however, imply the postponement of essential reforms such as the restoration of macroeconomic stability and the achievement of a realistic exchange rate. It will often be necessary to reduce unsustainable fiscal and balance-of-payments deficits. This will often involve reductions in public expenditure, the tightening of monetary policy and devaluation. But the dangers of overshooting and wrongly sequencing policies should be avoided since these lead to a greater than necessary contraction of demand and employment. It has, for example, been observed that in early structural adjustment programmes "there was too much focus on repressing the current deficit. ... These measures together potentially reduced output more than necessary by cutting all current investment, reducing the profitability of previous government investments by starving projects for operating and maintenance costs, and reducing incentives for government employees to work productively."[14]

Similarly, over-shooting in terms of the tightening of monetary policy can lead to unnecessary plant closures and loss of jobs. Moreover, apart from getting the dosage right it will also be important to avoid inconsistent policies. For instance, as illustrated by the recent experience of Argentina and Mexico, the prolonged use of a fixed exchange rate as an anchor for anti-inflation policy runs the danger of a return to currency over-valuation and a subsequent currency crisis that seriously sets back the reform process.[15] Continuing over-valuation of the exchange rate inhibits the growth of exports that is essential to the success of the reform process, while the high interest rates necessary to support the exchange rate depresses domestic demand unduly. Furthermore, the large short-term capital inflows that are attracted under such a strategy increase the vulnerability of the whole reform programme to destabilizing capital outflows.

A particularly important aspect of the pace of reform is trade liberalization. A radical, across-the-board trade liberalization as part of a "big-bang" strategy is likely to lead to unnecessarily high social costs. As mentioned earlier, imports would increase rapidly while exports can only increase more gradually. This problem would be compounded where there is little real effective devaluation of the exchange rate. As a result job losses would greatly exceed job creation and there would, at the same time, be strong pressure on the balance of payments. There is thus a case for a more gradual and selective approach to trade liberalization.

This case rests not only on the need to mitigate the transitional employment problem but also, in some cases, on infant-industry arguments. While old-style import substitution strategies of industrialization have been widely discredited, it is important not to throw the baby out with the bath water in the zeal for market reforms. The main reason why import substitution strategies failed was that they granted protection indiscriminately and failed to provide adequate incentives for even potentially viable industries to increase their international competitiveness. But this failure does not obviate the underlying economic arguments for selective protection of infant industries; in many developing countries there are still market failures which need to be compensated for.[16] What it does define is the challenge of designing improved, incentive-compatible ways of promoting such industries.

It would thus be important to consider alternatives to a radical, across-the-board approach to trade liberalization. One option is to be selective in two respects. The first is to proceed rapidly with the liberalization of imports (capital and intermediate goods) necessary for the expansion of exports.[17] The second is to maintain selective protection for potentially competitive industries but to make such protection clearly time-bound and conditional upon meeting agreed performance criteria.[18] Provided the administrative capacity exists for the effective implementation of such a strategy, it will have the double advantage of both moderating the social costs of economic reform and promoting desirable industrial growth.

A central issue in economic reform is the need to continue efforts to reduce poverty and inequality. While market reforms are essential for sustainable employment growth and poverty alleviation, they are unlikely to be sufficient. Especially in countries with continuing high levels of poverty and inequality, market reforms will need to be supported by redistributive measures. A basic reason is that the poor who are typically assetless, uneducated and without access to credit will not be able to respond adequately to the new economic opportunities created by market reforms.[19] The "trickle down" effects of market reforms will thus be weak unless they

are accompanied by programmes to strengthen the productive capacity of the poor. For example, economic reforms often result in a shift in the terms of trade in favour of agriculture, a necessary correction of an important aspect of past urban bias. But small and marginal farmers, especially those in ecologically fragile and remote areas, are handicapped in terms of their access to credit, irrigation, productive inputs and extension services and hence cannot benefit fully from improved terms of trade for the agricultural sector. Worse, their position is often weakened by cut-backs in government support services to the rural sector as part of the overall quest under market reform programmes for reduced government intervention and lower public expenditure. Not only would this aggravate the handicaps of the poor, it could also pave the way for disequalizing changes such as the strengthening of the position of larger farmers and the growth of capital-intensive agro-business.

The market reforms should thus be accompanied by greater effort to develop rural infrastructure, credit schemes, extension services and public works programmes rather than a reduction or elimination of these. Improvements in access to education and health services are also particularly important for poverty reduction. Where land ownership and holding are highly unequal there would be a case for considering land and tenancy reform measures. The benefits of such measures would lie not only in the reduction of poverty but also in higher growth of output. The evidence remains persuasive that there is an inverse relationship between farm size and land and labour productivity.[20] In addition, cross-country studies consistently point to an inverse relationship between the degree of inequality in the distribution of assets and the rate of economic growth.[21]

Outside the rural sector, policies to promote the growth of medium and small enterprises will be particularly important. This should include action to remove unnecessary regulatory obstacles to enterprise formation and growth, selective support in the upgrading of technology and in the development of export markets, and measures to improve access to credit. The coverage of such programmes should be extended to micro-enterprises and self-employment activities in the informal sector. Given the likelihood of job losses in the modern sector in the initial stages of economic reform, the informal sector can play a useful role as a "safety net" for displaced workers.

However, it has to be recognized that past strategies of redistribution were often poorly designed and implemented. There was inadequate attention to the importance of a supportive macroeconomic environment and to the minimization of micro-economic distortions and leakages to the non-poor. For example, employment generation programmes have been nullified by macro-policies which favoured labour displacement while credit programmes failed to ensure adequate financial discipline and to provide necessary incentives for loan recovery and repayment. Thus, while the case for redistributive reforms still remains strong it is important that these mistakes of the past be avoided in the design of a new generation of redistributive policies. With successful market reforms the problem of macroeconomic incompatibility should diminish, hence the main focus has to be on the design of more incentive-compatible poverty alleviation measures. For example, past land reform programmes tended to be based on the compulsory redistribution of land, with or without compensation. However, the objective of a more equal distribution of access to land could be achieved, albeit more gradually, through inheritance taxes, progressive taxation of rural incomes to finance programmes targeted on the rural poor, and market-friendly measures to increase access of the poor to land.[22]

LABOUR MARKET REGULATION AND EMPLOYMENT

A controversial aspect of economic reform in developing countries is whether or not there is a need to undertake extensive deregulation of labour markets. The background to this is the considerable disagreement about the impact of labour market institutions and policies on economic development and employment creation in developing countries. In particular, two competing perspectives have emerged from the academic and policy debate.[23] On one side, there are economists who view government regulations, such as mandatory benefits, social security contributions, minimum wages, severance pay and collective bargaining, basically as "distortions" in otherwise perfectly functioning markets. These economists maintain that such interventions raise the cost of labour in the formal sector and hence reduce labour demand, exacerbate inequalities between the formal and informal sectors, impede adjustment to economic shocks by reducing employment and wage flexibility, reduce international competitiveness by raising the cost of labour, and reduce the rate of growth by lowering returns on investment. On the opposite side are those who stress that labour market institutions and policies help to reduce poverty, improve productivity and foster economic growth, thus enhancing social welfare in developing countries.

The case for labour market deregulation rests crucially on the claim that labour market regulations in developing countries mandate excessively high benefits and are highly distortionary. Yet there has been very little direct empirical evidence to support this claim. In the following paragraphs an attempt will be made to examine its validity. In table 5.3 labour market regulations in selected developing countries are shown, while table 5.4 sets out information on social security programmes and non-wage labour costs for a wider set of countries.

It is often argued that minimum wages in developing countries are distortionary because they are set too high relative to the average income and to other wages in the economy, thus raising production costs in the formal sector and discouraging employment. The argument is also made that minimum wage provisions cannot be justified on equity grounds because they only try to protect urban formal workers who already earn much higher wages than the poor in the informal sector.[24]

However, such minimum wage interventions seem to be far from the norm in most developing countries:

— First, as can be seen in table 5.3, the level of the legal minimum wage as a percentage of average wage is relatively low in the developing countries for which data are available. It was only 15.6 per cent in Chile, and the highest was 75.8 per cent in Thailand.

— Moreover, the level of real minimum wages fell precipitously in many developing countries in recent decades. For example, in 1992 the real minimum wage in Mexico fell to 68 per cent of its 1980 value. During the period 1980-90, the real minimum wage fell to 73.3 per cent of its 1980 value in Chile and to 48.2 per cent in Guatemala. In Uganda the minimum wage fell to 10 to 15 per cent of its 1972 value in the 1980s. In the Republic of Tanzania, too, the minimum wage dropped to 18 per cent of its 1972 value in 1989.[25] Thus, contrary to the claims of those who believe that labour markets are seriously distorted, the minimum wages have shown enormous flexibility

Table 5.3. Labour market regulations in developing countries

Country/area	Minimum wage provision		Employment security legislation		Maternity protection	Cash benefits[a] (percentage of average wage)	Industrial relations
	Minimum wage established by law?	Minimum wage[1] (percentage of average wage)	Period of notice[2] (days)	Severance pay[3] (monthly wage)	Period of leave (days)		Unionization[4] (percentage of labour force)
Latin America							
Argentina	Yes	33.3[a]	30-60*	3.00	90	100	28
Bolivia	Yes		30-90**	3.00	60	100	29
Brazil	Yes		30	3.00	120	100	
Chile	Yes	15.6[b]	30	3.00	126	100	14.7
Costa Rica	Yes	67.4[c]	30	3.00	120	100	15
Mexico	Yes	23.3[a]	n.s.	7.33	84	100	25-30
Sub-Saharan Africa							
Côte d'Ivoire	Yes		n.s.	n.s.	98	100	
Ghana	Yes		30**	n.s.	84	50 or more	14
Kenya	Yes		28	0	60	100	5
Senegal	Yes		n.s.	n.s.	98	100	
South Africa	Yes		7-14**	n.s.	84	45	
Tanzania, United Republic of	Yes		n.s.	1.80	84	100	
Zimbabwe	Yes		30	n.s.	90	60-75	17
North Africa and the Middle East							
Algeria	Yes		n.s.	3.00	98	100	
Egypt	Yes		n.s.	n.s.	50	100	50
Morocco	Yes				84	100	5
Tunisia	Yes		30	1.20	30	66.7	10
Turkey	Yes	61.6[e]	28-56*	3.00	84	66.7	20
Asia							
Bangladesh	Yes		30	3.00	84	100	3
Hong Kong	No		n.s.	2.00	70	66.7	20.9
India	Yes		14-30**	0.00	84	100	24
Indonesia	Yes		n.s.	4.00	90	100	
Korea, Republic of	Yes	24.1[a]	30		60	100	17.2
Malaysia	No		28-56*		60	100	15
Pakistan	Yes		30	2.00	84	100	10
Philippines	Yes	58.3[d]	30	3.00	60	100	12
Singapore	No		7-28*	0.00	56	100	14
Taiwan	Yes		20-30*	3.00	56	100	34.9
Thailand	Yes	61.7-75.8	n.s.	6.00	90	50	1.6

[1] Calculated as percentage of average manufacturing wage. Figures for Mexico and Philippines are calculated on the basis of daily earnings, while figures for other countries are based on monthly earnings. [2] Assuming that an employee had one year of continuous employment. [3] Assuming three years of employment; in the event that the period of notice is not observed, compensation usually increases by monthly wage for the prescribed period of notice. [4] Percentage of average wages paid for statutory period of maternity leave. [5] Estimated as percentage of employed labour force.

* Based on length of service. ** Based on type of wage contract. n.s. = not specified.

[a] Data for 1993. [b] Data for 1993. [c] Data for 1985. [d] Data for 1994.

Source: Minimum wage provision: Calculated from ILO, LABMINW database, which contains data on legal minimum wage rates; ILO: *Yearbook of Labour Statistics*, various years. Employment security legislation and maternity protection: Taken from US Social Security Administration, Office of Research and Statistics: *Social security programs throughout the world — 1995*; ILO: *Conditions of work digest: Maternity and work*, Vol. 13, 1994. Unionization: taken from M. Upham: *Trade unions and employers' organizations of the world* (London, Cartermill, 1995); World Bank: *World Development Report, 1995*; *Workers in an integration world* (Oxford University Press, 1995); ILO Bureau of Labour Statistics: Statistics of trade union membership (unpublished), which contains data for 37 countries taken from national statistical publications (February 1995).

— Not only are minimum wages set very low but coverage and compliance with minimum wages are far from universal.
— A review of empirical evidence on the effect of minimum wages suggests that the minimum wage rarely distorts the labour market seriously. It seems that countries rarely set minimum wages at levels that cut seriously into employment.[26]

It is usually thought that, in addition to minimum wages, mandatory benefits and contributions to social security programmes work to reduce employment and impede growth and competitiveness by increasing non-wage labour costs of firms. According to table 5.3, countries throughout the developing world tend to provide very much standardized levels of employment security and maternity protection provisions. In other words, employers face very similar levels of costs in terms of the notice period for dismissal, severance pay, period of maternity leave, and maternity cash benefits. This cannot therefore be a factor that influences the relative international competitiveness of developing countries. Moreover, the level of these provisions is very modest; the period of notice for dismissal rarely exceeds one month while the level of severance pay rarely exceeds three months' wages. These can hardly be described as imposing excessive rigidity and costs or a serious hindrance to labour hiring. They would appear to be at no more than a minimal level required to provide a modicum of employment security and equity.

Table 5.4 summarizes the social security provisions in effect at the beginning of 1995. As can be seen, most countries commonly provide old-age, disability and death insurance, sickness or maternity benefits, and work injury insurance. On the other hand, only about one-third of the countries listed in the table provide family allowances. The least commonly provided is unemployment insurance. Even in countries where unemployment benefits are provided, they tend to be much less generous than those found in industrialized countries. Employment security and maternity benefits also tend to be much less extensive than those provided in advanced economies.

The rates of social security contributions from workers and employers vary greatly from country to country and are not typically higher than those found in industrialized countries. In Latin America, where social security programmes have been far more extensive than in most other areas of the developing world, the rates of social security contributions are not significantly higher than in other regions or industrialized economies. For example, the contribution rates in Mexico (29.8 per cent) and Brazil (33.3 per cent) in 1995 are lower than those of the Republic of Korea (42.9 per cent) or Singapore(40.0 per cent); they are also lower than those of such industrialized countries as Italy (57.0 per cent), France (52.6 per cent), Netherlands (49.7 per cent), Austria (42.5 per cent), Belgium (40.5 per cent), Spain (38.3 per cent), and Portugal (37.8 per cent).

There is thus no clear-cut empirical support for the claim that high non-wage labour costs hamper economic performance. A recent econometric study found that higher levels of social security contributions were associated with higher, not lower, total employment growth and had no significant effect on output growth in Latin America and the Caribbean.[27] This study also found that measures of severance pay, maternity leave and paid annual leave did not have any significant effect on the growth rates of either total employment or output in this region. Thus, none of the labour market policies traditionally emphasized by the distortionist view show any of the hypothesized negative effects on employment and growth.

Table 5.4. Social security and non-wage labour costs in developing countries

Country/area	Types of social security programme					Total levies for financing social security benefits		
	Old age, disability and death	Sickness and maternity[1]	Work injury	Unemployment	Family allowances	Worker (% of earnings)	Employer (% of payroll)	Total (%)
Latin America								
Argentina	X	X	X	X	X	15.0	31.9	46.9
Bolivia	X	X	X	O	X	6.0	17.5	23.5
Brazil	X	X	X	X	X	Up to 10	Up to 23.3	Up to 33.3
Chile	X	X	X	X	X	20.0	Up to 7.7	Up to 27.7
Colombia	X	X	X	O	X	7.1	Up to 26.1	Up to 33.2
Costa Rica	X	X	X	X	X	8.0	19.0	27.0
Ecuador	X	X	X	X	O	8.0	9.6	17.6
El Salvador	X	X	X	O	O	7.0	17.0	24.0
Guatemala	X	X	X	O	O	4.5	10.0	24.5
Honduras	X	X	X	O	O	6.0	12.0	18.0
Jamaica	X	M	X	O	O	5.0	7.5	12.5
Mexico	X	X	X	O	X	5.2	24.6	29.8
Nicaragua	X	X	X	O	X	5.8	14.5	20.3
Paraguay	X	X	X	O	O	28.5	39.0	67.5
Peru	X	X	X	O	O	6.0	Up to 24.2	Up to 30.2
Uruguay	X	X	X	X	X	42.0		
Venezuela	X	X	X	X	O	12.7	Up to 25.0	Up to 25.7
Sub-Saharan Africa								
Cameroon	X	M	X	O	X	2.8	Up to 23.2	Up to 26.0
Congo	X	M	X	O	X	2.4	16.1	18.5
Côte d'Ivoire	X	M	X	O	X	1.6	Up to 12.9	Up to 14.5
Ethiopia	X	M	X	O	O	8.0	12.0	20.0
Ghana	X	M	X	O	O	5.0	12.5	17.5
Kenya	X	X	X	O	O	5.0	5.0	10.0
Madagascar	X	M	X	O	X	1.0	21.4	22.4
Mali	X	M	X	O	X	3.6	Up to 19.4	Up to 23.0
Nigeria	X	X	X	O	O	5.0		
Senegal	X	M	X	O	X	Up to 7.8	Up to 22.2	Up to 30.0
South Africa	X	X	X	X	O	1.0	1.0	2.0
Sudan	X	M	X	O	O	7.0	19.0	26.0
Tanzania, United Republic of	X	M	X	O	O	10.0	10.0	20.0
Uganda	X	M	X	O	O	5.0		
Zaire	X	X	X	O	X	3.5	9.0	12.5
Zambia	X	M	X	O	O	10.0		
Zimbabwe	X	M	X	O	O	3.0	3.0	6.0
North Africa and the Middle East								
Algeria	X	X	X	O	X	5.0	24.0	29.0
Egypt	X	X	X	X	O	Up to 15.0	Up to 35.0	Up to 50.0
Morocco	X	X	X	O	X	3.5	16.4	19.9
Tunisia	X	X	X	X	X	Up to 10.7	Up to 29.0	Up to 39.7
Turkey	X	X	X	O	O	Up to 14.0	Up to 27.0	Up to 41.0

Country/area	Types of social security programme					Total levies for financing social security benefits		
	Old age, disability and death	Sickness and maternity[1]	Work injury	Unemployment	Family allowances	Worker (% of earnings)	Employer (% of payroll)	Total (%)
Asia								
Bangladesh	X	X	X	X	O	0		
Fiji	X	M	X	O	O	7.0		
Hong Kong	X	X	X	X	X	0		
India	X	X	X	O	O	Up to 11.5	Up to 14.7	Up to 26.2
Indonesia	X	X	X	O	O	2.0	Up to 11.7	Up to 13.7
Korea, Republic of	X	X	X	O	O	Up to 3.9	Up to 39.0	Up to 42.9
Malaysia	X	M	X	O	O	10.0	13.3	23.3
Myanmar	O	X	X	O	O	1.5	2.5	4.0
Nepal	X	M	X	O	O	10.0		
Pakistan	X	X	X	O	O	0	12.0	12.0
Papua New Guinea	X	O	X	O	O	5.0		
Philippines	X	X	X	O	O	4.6	7.3	11.9
Singapore	X	X	X	O	O	20.0	20.0	40.0
Sri Lanka	X	M	X	O	O	8.0		
Taiwan	X	X	X	O	O	Up to 9.0	Up to 13.6	Up to 22.6
Thailand	X	X	X	O	O	1.5	Up to 3.5	Up to 5.0

X = Yes; O = No; M = Maternity benefits only.

[1] Sickness and maternity refers to cash benefits for sickness and maternity.

Source: US Social Security Administration, Office of Research and Statistics: *Social security programs throughout the world — 1995*; ILO: *Conditions of work digest: Maternity and work*, Vol. 13, 1994.

This does not of course mean that the status quo with respect to labour market regulations should always be preserved; there may well be aspects that are in need of reform in particular countries. But what it does mean is that there is no basis for a blanket presumption that labour market regulations are invariably sources of rigidity and that deregulation is always called for. Whether or not there is a need for reform has to be ascertained from a specific examination of the empirical evidence. Moreover, a serious attempt has to be made to devise improved alternatives which can achieve the intended objectives of the existing regulation in a more efficient way rather than to assume that deregulation is automatically the optimal solution. It is also essential that the social partners be fully involved in the process of reform.

Notes

[1] See ILO: *World Employment 1995* (Geneva, 1995), Ch. 2.

[2] See A. De Janvry, M. Warning and E. Sadoulet: *Rural labor in Africa* (Geneva, ILO, 1995, mimeographed): "Of the 26 countries with data for both food and export crops, 77 per cent had falling food production per capita and 81 per cent falling agricultural exports per economically active population in agriculture in 1987-92 ... Food production has thus been unable to keep up with population, and the productivity of labour in export agriculture has also been falling" (p. 3).

[3] J. Weeks: *Macroeconomic policies for employment generation: Africa south of the Sahara* (Geneva, ILO, 1994).

[4] D. Mazumdar: *Wages in Africa* (Washington, DC, World Bank, 1994).

[5] M. Karshenas: *Macroeconomic policies, structural change and employment in the Middle East and North Africa*, Paper No. 2, prepared under the ILO/UNDP project "Economic policy and employment" (Geneva, ILO, 1994).

[6] In the late 1980s and early 1990s the employment elasticity of output growth ranged from 0.28 to 0.46 in Asian countries for which data are available (India, Indonesia, Republic of Korea, Malaysia, Pakistan and Thailand) and from 0.47 to 0.9 in five Latin American countries (Bolivia, Chile, Colombia, Costa Rica and Jamaica). Furthermore, there are indications that employment elasticities have been declining in some of these countries. Employment elasticities declined from 0.79 in 1975-80 to 0.28 in 1986-92 in India and from 0.53 to 0.35 respectively in Pakistan. Declining employment elasticities were also observed among Latin American countries. Comparing the periods 1975-80 and 1986-92, employment elasticities declined from 0.51 to 0.47 in Chile, and 0.76 to 0.74 in Costa Rica. The continuation of these trends into the future would require larger rates of GDP growth just to absorb the increase in the labour force (ILO calculations based on ILO: *Yearbook of Labour Statistics*, various issues, and World Bank, world tables 1994).

[7] The World Bank classifies countries according to how intensively they use adjustment lending. Grouping of countries in this section corresponds to the last published evaluation (World Bank, 1992). Intensive adjustment lending countries (IALC) are those who "received at least two structural adjustment loans or three adjustment loans of any type ...". Only countries with several loans are included because one loan is typically not enough to support continuous policy reform. Other countries that received adjustment loans effective by the end of fiscal 1990 are in the "other adjustment lending" category (OALC). Non-adjustment-lending countries (NALC) are those with no adjustment loans effective by the end of fiscal 1990. Please refer to table 5.2 for a listing of countries in each category.

[8] ECLAC: *Panorama Económico de América Latina, 1995: Argentina, Brasil, Colombia, Chile, Ecuador, México, Perú, Uruguay, Venezuela* (Santiago de Chile, 1995).

[9] The rate of growth of exports has decreased for all adjusting countries in Latin America. In IALC exports were growing at an average rate of 11.43 per cent a year between 1975-80; this declined to 9.16 per cent a year in 1981-85, and 6.19 per cent in 1986-93. For OALC average export growth was 11.06, 5.89 and 2.01 per cent a year in the respective periods of time (World Bank: world tables 1994).

[10] World Bank, Country Economics Department: *Adjustment lending and mobilization of private and public resources for growth*, Policy and Research Series No. 22 (Washington, DC, 1922), p. 10.

[11] Taken as a group, there was a slight improvement in the rate of savings within IALC. As a ratio to GDP, savings increased from 20.95 per cent in 1975-80 to 22.53 per cent in 1981-85 and to 22.84 per cent in 1986-93. Such improvement, however, did not translate into higher rates of investment, which actually declined from 22.74 per cent of GDP in 1975-80 to 21.08 per cent in 1986-93. Exceptions to this trend were investment rates in Chile, Colombia and Costa Rica, where the ratio of investments to GDP had improved by 1986-93. Within OALC the decline in savings and investment rates was sharper. Savings decreased from 27.9 per cent of GDP in 1975-80 to 18.89 per cent in 1986-93; investment also contracted from 27.4 per cent to 17.15 per cent over the same period (refer to table 4.2 in the text).

[12] Paul Collier: *Recent African economic performance and its implications* (Geneva, ILO, 1995, mimeographed).

[13] Human Resources Development Convention, 1975 (No. 142), and Human Resources Development Recommendation, 1975 (No. 150).

[14] L. H. Summers and L. H. Pritchett: "The structural adjustment debate", in *American Economic Review*, May 1993, pp. 383-389.

[15] R. Dornbush: *Stabilization, debt and reform: Policy analysis for developing countries* (London, Harvester Wheatsheaf, 1993).

[16] P. Mosely, "Development economics and the underdevelopment of sub-Saharan Africa", in *Journal of International Development*, Vol. 7, No. 5, pp. 685-706.

[17] J. Toye: *Structural adjustment and employment policy: Issues and experience* (ILO, Geneva, 1995).

[18] P. Mosely, op. cit.

[19] M. Lipton, "Market, redistributive and proto-reform: Can liberalization help the poor?", in *Asian Development Review*, Vol. 13, No. 1, pp. 1-35.

[20] ibid.

[21] S. Bowles and H. Gintis: "Productivity-enhancing egalitarian policies", in *International Labour Review*, 1995/4-5, pp. 559-585.

[22] M. Lipton, op. cit.

[23] For a summary of the differing views, see R. B. Freeman: "Labour market institutions and policies: Help or hindrance to economic development?", in *Proceedings of the World Bank Annual Conference on Development Economics* (Washington, DC, 1992).

[24] See, for example, World Bank: *World Development Report 1995: Workers in an integrating world* (Oxford, Oxford University Press, 1995), Ch. 11.

[25] V. Jamal and J. Weeks: *Africa misunderstood, or whatever happened to the rural-urban gap?* (Macmillan Press, 1993), Ch. 4.

[26] Freeman posits that countries follow a strategy of "optimal selective enforcement" of minimum wage (and other) regulations, that is, they effectively implement these laws when the cost is modest in terms of lost jobs, but they enforce the laws weakly when the cost of employment is sizeable. Op. cit., pp. 128-129.

[27] M. Rama: *Do labour market policies and institutions matter? The adjustment experience in Latin America and the Caribbean* (Washington, DC, World Bank, mimeographed, Mar. 1995).

CHAPTER VI

CONCLUSIONS

THE OBJECTIVE OF FULL EMPLOYMENT

A major question addressed by the report has been whether the objective of full employment is still relevant and realistic today. The main sources of scepticism over the continuing relevance of full employment — the belief in the onset of "jobless growth" due to labour-displacing technical change and the view that there has been a revolutionary change in the nature of work that renders the concept of full employment obsolete — were assessed in the light of available empirical evidence. It was found that there was very little basis for these fears. The rise in unemployment in the industrialized countries in the past two decades has not been due to a fall in the employment content of growth but has rather been the result of faster growth of the labour force and lower rates of economic growth. Consequently there is no reason to reject the objective of full employment and to replace it with the alternative agenda of devising new social institutions to adapt to a future dearth of jobs. In any case the main proposals on the alternative agenda, such as the delinking of income from work, are utopian.

Full employment should thus be retained as a priority objective of economic and social policies. It remains the best available means of ensuring equity, of meeting peoples' aspirations for participation in economic and social life, and of preserving social cohesion. It also ensures the full utilization of human and capital resources and the maximization of the rate of growth of output and of living standards. In contrast, high unemployment breeds exclusion and other social ills, increases poverty and inequality, and inflicts a high cost on the unemployed in terms of reduced well-being. It also represents a wasteful underutilization of human and other productive resources.

This is true of countries at all levels of development, even though the concept of full employment may have to be interpreted differently in the case of developing counties. In the industrialized countries the definition of full employment as a level of employment where all those actively seeking work can obtain it remains fundamentally valid. There may, however, be a need to update the concept in line with changes that have taken place in the structure of employment, such as the increasing share of female employment, the emergence of freely chosen forms of flexible employment, and perhaps a higher turnover of jobs. This will imply the need for new policies and institutions, especially for ensuring employment security and social protection.

In developing countries the objective of full employment is no less important, in spite of the fact that the structure of employment is very different from that in industrialized countries where the concept was developed. Only a minority of the employed are in formal wage employment in the modern sector, the rest being in

peasant farming, casual labour or low productivity self-employment in the informal sector. This, together with the absence of unemployment benefits, implies that full employment cannot be defined only in terms of a target rate of unemployment. But it is possible to measure progress towards full employment by using a combination of indicators such as the rate of growth in modern-sector employment and changes in average earnings and the degree of unemployment in the rural and informal sectors. Given the presence of widespread underemployment and poverty in developing countries it is clear that attaining full employment in the sense of providing productive and decent employment for all who seek it is a long-term objective, but this does not detract from its usefulness as an overarching policy objective. It provides a framework for formulating policies for raising both the volume and the quality of employment and, thereby, for ensuring that economic growth is equitable and poverty-reducing.

THE GLOBAL CONTEXT

Achieving full employment will be a challenging task, requiring fundamental economic reforms in many countries and actions at the international level. The ongoing globalization of the world economy offers the potential for achieving higher growth of output and employment worldwide. Expanding flows of international trade and investment provide for the mutually beneficial expansion of markets and improved allocation of resources in the world economy. This will lead to an expanding global economy from which countries at all levels of development stand to benefit. But, in order to realize this potential in full, actions are required at the international level to promote stable and open economic relationships among nations.

Among the actions required are, first, a commitment from all countries to adhere to common rules of the game in maintaining open economic policies and refraining from policies that confer on them an unfair competitive advantage. Universal compliance with basic labour standards will make an important contribution to preventing a resurgence of protectionism as well as to ensuring equity in the face of rising international economic competition. Secondly, enhanced coordination of macroeconomic policies among the major industrial economies will allow for higher growth in these countries, which in turn will provide a major boost to growth in the transition and developing economies. Thirdly, effective arrangements need to be developed to overcome problems associated with the increasing globalization of financial markets, such as the rapid growth of volatile short-term financial flows which destabilize economic growth and employment. These arrangements should seek to reduce the likelihood of financial crises in individual countries and to limit the contagion effects of such crises through more effective and timely arrangements for their resolution. Fourthly, international assistance needs to be provided to the least developed countries to enhance their capacity to compete successfully in the globalized world economy. This will help to reverse their marginalization from the benefits of globalization and to bring about a desirable reduction in international inequalities and world poverty.

National policies

Industrialized countries

In the industrialized countries a combination of macroeconomic and labour market policies will be required to reverse the drift away from full employment that has occurred in many countries. The main manifestations of the shortfall from full employment have been a persistence of high unemployment, widening wage inequalities and increasing labour market polarization.

There is no consensus either on the causes of these phenomena or on the policies required to overcome them. With respect to the rise and persistence of unemployment, an influential view is that this has been caused by labour market rigidities and over-generous levels of social protection. According to this view the main solution lies in labour market deregulation and reductions in levels of social protection. An opposing view is that it is the prolonged period of low growth in output and productivity that has been the main cause. This has led to low investment and hence inadequate productive capacity for output and employment to grow much before inflationary pressures set in. Moreover, low productivity growth has left much less room for the non-inflationary resolution of competing income claims. According to this view the main solution lies in policies to raise the rate of growth in productive capacity, supported by efforts to ensure that wage settlements remain within macroeconomic constraints.

There has been a debate over the causes of the rise in wage inequality. Some have argued that the fall in the relative wage of unskilled workers has been caused by increasing trade with low-wage economies, while others have blamed it on skill-biased technical progress that has reduced the demand for unskilled workers. But the available evidence indicates that, while these factors have played a role, they have not been the main culprits. Other factors such as changes in labour market institutions and the prolonged period of low growth and high unemployment have probably been more important. With high unemployment unskilled workers have been displaced from a larger proportion of available jobs by the more skilled, hence accounting for the higher incidence of unemployment and lower pay among the unskilled. This provides another reason for believing that higher growth will, apart from reducing overall unemployment, also contribute to a lowering of wage inequalities.

Increasing labour market polarization, reflected in the growth of low-paid and insecure jobs at the lower end of the labour market, has been caused by several factors. The shift in the structure of employment towards the service sector and increasing female labour force participation have been partly responsible. But the process could also have been driven by changes in the employment strategies of enterprises resulting from increased uncertainty and instability in the macroeconomic environment. Thus, higher and more stable levels of aggregate demand could contribute to reversing the preference for more flexible employment contracts.

Given the above lack of agreement on the causes of the current employment problems in the industrialized countries, no single set of policy prescriptions is likely to gain general support. While mindful of this, the report has nevertheless argued the case for a strategy based on policies to restore higher rates of growth of output, of productive capacity, and productivity. This will involve the simultaneous implementation of macroeconomic policies aimed at securing a higher and more

stable level of demand and of labour market policies to improve the employment prospects of low-skilled workers. The macroeconomic part of the strategy will involve a strong and credible reduction in real interest rates that will bring about a reduction in the debt-servicing burden and thus facilitate the reduction in fiscal deficits. The reduction in fiscal deficits and public debts should still remain as a major medium-term objective, but the required restrictive measures should be applied only after the economies have been placed on a sustained path of higher growth. It is only with increased tax revenues from higher growth and the savings on social security from lower unemployment that a sustained reduction will be possible in public deficits and debt. In addition, in order to maintain incentives to invest and to contain inflationary pressures, wage settlements will have to be kept within macroeconomic constraints. Successful implementation of incomes policies and other institutional mechanisms for regulating pay settlements is thus critical to the success of the strategy. Similarly, financial markets will have to be reassured that the medium-term objective of deficit reduction is credible because of higher growth and sustained reduction of short-term interest rates. Stronger coordination of macroeconomic policies will also be required to ease external deficit problems and soften losses of competitiveness generated by inflationary tensions, at the same time as it reinforces the credibility of the policies.

It is, however, essential that these macroeconomic policies be accompanied by labour market policies to upgrade the skills and the employability of low-skilled workers, especially those in long-term unemployment. Policies aimed at reducing the cost of low-skilled workers, such as a reduction in the payroll taxes applicable to them or targeted employment subsidies, will also be important.

Transition economies

The former centrally-planned economies have experienced a rapid emergence of mass unemployment since the beginning of the process of transition to a market economy. Significant progress has been made in this transition process in many countries, although the achievements have been uneven across countries. But even in the countries most advanced in the reform process much remains to be done, especially in the area of enterprise restructuring, before they become full-fledged and competitive market economies.

A major policy challenge is to reduce current high levels of unemployment while pressing ahead with the transition process. This will not be easy to achieve since a key objective of further reforms would be to raise labour productivity and eliminate genuinely uncompetitive activities. This will imply further job losses and a consequent rise in unemployment unless new jobs are created rapidly enough to prevent this. A vital element of employment policies should thus be to promote job creation in competitive new private sector activities. This will require a strengthening of the capacity for macroeconomic management in order to ensure a supportive macroeconomic environment as well as a continuation of market reforms to provide the right incentives for investment and enterprise growth. But this may have to be supplemented by policies to moderate the rate of job losses and by recourse to direct employment creation schemes.

One among the possible policy instruments for moderating the rate of job losses is recourse to selective rather than across-the-board and instantaneous import

liberalization, coupled with selective export credits and subsidies to potentially competitive enterprises. This could be backed up by the provision of selective, time-bound subsidies that are conditional upon strict performance criteria to potentially competitive enterprises (those generating positive value-added, for instance) that are undergoing restructuring. In doing so it is important to avoid creating perverse incentives that could delay necessary restructuring. Another possible policy instrument is to rely more on public works programmes to generate employment. The benefits would include not only the value of assets and income that are created but also the savings in unemployment benefits. Yet another possibility is to adopt a more relaxed policy towards self-employment in the unregistered economy. Such a strategy appears feasible from a fiscal standpoint since it can be financed to a large extent from the reallocation of existing expenditure and savings in unemployment and related benefits. But an important condition for success is tripartite cooperation to ensure that temporary support to enterprises is matched by wage restraint and appropriate enterprise policies.

Developing countries

Many developing countries have experienced a deterioration in employment conditions since the early 1980s in the wake of the debt crises and subsequent adjustment problems. A critical condition for reversing this deterioration in employment conditions is to restore higher and more stable rates of growth. Only high growth can ensure the rate of growth of productive employment that is required to cope with high rates of labour force growth as well as to reduce the share of low-productivity jobs in total employment and thereby contribute to the alleviation of poverty.

In some countries, for the most part the least developed countries of sub-Saharan Africa, the basic preconditions for economic growth, such as civil peace and a minimal level of macroeconomic stability, remain to be established. In others the restoration of higher and sustained growth after the debt-related economic crises of the early 1980s has still not been fully achieved. In these countries there is still a considerable challenge in terms of economic reform. More generally, apart from the rapidly growing economies in East and South-East Asia, economic reforms of varying degrees need to be implemented in many developing countries before they can benefit fully from globalization and achieve high and sustained growth.

The objective of most economic reform programmes is to move towards a more open and market-oriented economy. This involves trade and currency liberalization as well as various microeconomic reforms to remove price and other distortions and achieve greater efficiency in resource allocation. A major motivation for such reforms is the need to increase international competitiveness and thereby to benefit more from expanding trade and investment flows in the global economy. Successfully implemented, such reforms should lead to higher growth and an increased pace of productive job creation. Successful reform is thus the cornerstone of efforts to put developing countries firmly on the path of achieving full employment.

But, as in the case of transition economies, there is likely to be a high social cost associated with the reform process. The heart of the problem is that jobs in uncompetitive activities are likely to be destroyed faster than new jobs can be created in new competitive activities. There is thus a need for careful management of the pace

and sequencing of economic reforms with a view to minimizing social costs. Trade liberalization could be managed more gradually and selectively and be combined with programmes to increase the capacity of producers to respond to new market opportunities. Such programmes would include investment to remove bottlenecks in infrastructure, enhancing the capacity of training systems to respond to the demand for new skills and improving the access of small and medium enterprises to credit. It will also be important to avoid errors in macroeconomic management that cause unwarranted contractions in output or provoke new exchange-rate and debt crises.

While market reforms are essential for sustainable employment growth and poverty alleviation they are unlikely to be sufficient. Especially in countries with high levels of poverty and inequality, market reforms will need to be supplemented by redistributive reforms designed to strengthen the capacity of the poor to respond adequately to new economic opportunities. There should thus be greater effort to develop rural infrastructure, credit schemes, extension services and public works programmes. Where land ownership is highly unequal, there would be a case for considering land and tenancy reform measures. Outside the rural sector, programmes to promote the growth of small and medium enterprises will be particularly important. These should be extended to micro-enterprises and self-employment activities in the urban informal sector, given their role as a "safety net" for displaced workers. In addition the capacity to design and implement programmes to compensate for the negative effects of economic reform needs to be strengthened. However, all these measures need to be carefully designed in order to avoid past mistakes which reduced their effectiveness. There has to be greater attention to minimizing microeconomic distortions and leakages of benefits to the non-poor, and to providing the right incentives to intended beneficiaries.

A controversial aspect of economic reform is whether or not there is a need to undertake extensive deregulation of labour markets. The case for deregulation rests crucially on the claim that labour market regulations in developing countries mandate excessively high benefits and are highly distortionary. But the evidence reviewed in the report on key aspects of labour market regulation such as those relating to minimum wages, employment security, maternity protection, social security programmes and non-wage labour costs do not confirm this contention. Thus, whether or not there is a need for reform has to be ascertained from a case-by-case examination of the empirical evidence, with the full involvement of the social partners.

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